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Title: T. H. Bell, Secretary of Education, United States Department of Education, Petitioner
v.
Kentucky Department of Education

Docketed:
May 3, 1984

Court: United States Court of Appeals for the Sixth Circuit

Counsel for petitioner: Solicitor General

Counsel for respondent: Chenoweth, Robert L.

Entry	Date	Note	Proceedings and Orders
1	Feb 27 1984		Application for extension of time to file petition and order granting same until May 3, 1984 (O'Connor, February 28, 1984).
2	May 3 1984	G	Petition for writ of certiorari filed.
3	Jun 13 1984		DISTRIBUTED. September 24, 1984
4	Jun 13 1984	X	Brief of respondent KY Dept. of Education in opposition filed.
5	Aug 16 1984	X	Reply brief of petitioner Bell. Sec. of Ed. filed.
6	Oct 1 1984		Petition GRANTED.
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7	Nov 2 1984		Joint appendix filed.
8	Nov 15 1984		Brief amicus curiae of Lawyers' Committee for Civil Rights Under Law filed. VIDED.
9	Nov 16 1984		Brief of petitioner Bell. Sec. of Education filed.
10	Dec 4 1984		SET FOR ARGUMENT. Tuesday, January 8, 1985. (3rd case)
11	Dec 6 1984		CIRCULATED.
12	Dec 12 1984		Record filed.
13	Dec 12 1984		Certified copy of C. A. proceedings received.
14	Dec 14 1984	X	Brief amicus curiae of Texas, et al. filed.
15	Dec 15 1984	X	Brief of respondent KY Dept. of Ed. filed.
16	Dec 19 1984		LODGING. (Miscellaneous report pamphlets and stucies)
17	Dec 19 1984	X	Brief amicus curiae of Natl. Assn. of Counties, et al. filed.
18	Dec 31 1984	X	Reply brief of petitioner Bell. Sec. of Ed. filed.
19	Jan 8 1985		ARGUED.

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PETITION FOR WRIT OF CERTIORARI

(1) 83-1798

No.

FILED
MAY 3 1984
ALEXANDER L. STEVAS,
CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1983

SECRETARY OF EDUCATION,
UNITED STATES DEPARTMENT OF EDUCATION,
PETITIONER

v.

COMMONWEALTH OF KENTUCKY,
DEPARTMENT OF EDUCATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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67 pp

QUESTION PRESENTED

Under a decision of the Secretary of Education interpreting Title I of the Elementary and Secondary Education Act of 1965 (20 U.S.C. (1976 ed.) 241a *et seq.*) and regulations issued thereunder, the Commonwealth of Kentucky misspent a portion of its Title I grant. The court of appeals concluded that the Secretary's interpretation of the statutory and regulatory requirements was reasonable and could be applied prospectively. However, the court held that the Secretary's interpretation could not be applied retroactively to require repayment of the misspent federal funds, since the statute and regulations were not unambiguous and the State's position was also reasonable.

The question presented is whether the right of federal agencies to recoup misspent grant funds is limited to cases in which no reasonable argument can be adduced to justify the expenditure.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

The Solicitor General, on behalf of the Secretary of Education, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-16a) is reported at 717 F.2d 943. The decisions of the Education Appeal Board and the Secretary of Education (App., *infra*, 17a-42a) are not reported.

JURISDICTION

The judgment of the court of appeals (App., *infra*, 43a) was entered on September 14, 1983, and a petition for

rehearing was denied on December 5, 1983 (App., *infra*, 44a). On February 28, 1984, Justice O'Connor extended the time for filing a petition for a writ of certiorari to and including May 3, 1984. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTE AND REGULATION INVOLVED

Title I of the Elementary and Secondary Education Act of 1965, 20 U.S.C. (1976 ed.) 241e(a)(3)(B), provided in relevant part:[1]

> Federal funds made available under this subchapter will be so used (i) as to supplement and, to the extent practical, increase the level of funds that would, in the absence of such Federal funds, be made available from non-Federal sources for the education of pupils participating in programs and projects assisted under this subchapter, and (ii) in no case, as to supplant such funds from non-Federal sources * * *.

45 C.F.R. 116.17(h) (1974) provided in relevant part:

> Each application for a grant * * * shall contain an assurance that the use of the grant funds will not result in a decrease in the use for educationally deprived children residing in that project area of State or local funds which, in the absence of funds under Title I of the Act, would be made available for that project area and that neither the project

[1] Title I has been revised on several occasions since its original enactment. The statute and regulations in effect during Fiscal Year 1974, the year involved in this case, are set forth in the text. Title I was amended and reorganized in the Education Amendments of 1978 (Pub. L. No. 95-561, 91 Stat. 2143, 20 U.S.C. 2701 *et seq.*) and superseded by Chapter 1 of the Education Consolidation and Improvement Act of 1981 (Pub. L. No. 97-35, 95 Stat. 464, 20 U.S.C. 3801 *et seq.*). However, apart from certain provisions of the 1978 legislation discussed in the text, the subsequent legislation does not affect the issues in this case.

> area nor the educationally deprived children residing therein will otherwise be penalized in the application of State and local funds because of such a use of funds under title I of the Act. * * * Federal funds made available for that [Title I] project (1) will be used to supplement, and to the extent practical increase, the level of State and local funds that would, in the absence of such Federal funds, be made available for the education of pupils participating in that project; (2) will not be used to supplant State and local funds available for the education of such pupils * * *.

STATEMENT

1. Title I of the Elementary and Secondary Education Act of 1965, as amended by the Education Amendments of 1978, 20 U.S.C. 2701 *et seq.*, was enacted to provide federal funding for "meeting the special educational needs of educationally deprived children" (20 U.S.C. 2701). State and local educational agencies obtain federal funds upon providing assurances to the Secretary of Education that the funds will be spent only on qualifying programs and in full compliance with statutory requirements. 20 U.S.C. (1976 ed.) 241e(a), 241f(a). In 1970, Congress added a provision requiring that the federal funds be used to supplement the level of funds that would, in the absence of federal funding, "be made available from non-Federal sources for the education of pupils participating in programs and projects assisted under [Title I]" (20 U.S.C. (1976 ed.) 241e(a)(3)(B)(i)). The provision went on to state that in no case could federal funds be used "to supplant such funds from non-Federal sources" (20 U.S.C. (1976 ed.) 241(a)(3)(B)(ii)). [2]

[2] The supplanting prohibition for the current Chapter 1 program (see note 1, *supra*) is in 20 U.S.C. 3807(b). See also 34 C.F.R. 200.62.

In Fiscal Year 1974 (the year involved in this case), the Secretary's regulations required grant applications submitted by local school districts to contain an assurance that the federal grant would not cause "a decrease in the use for educationally deprived children residing in [the] project area of State or local funds which, in the absence of [Title I] funds * * *, would be made available for that project area and that neither the project area nor the educationally deprived children residing therein will otherwise be penalized in the application of State and local funds because of such a use of [Title I] funds" (45 C.F.R. 116.17(h) (1974)). The regulations also required that Title I funds in fact be used to supplement the state and local funds that would otherwise be "made available for the education of pupils participating in [the Title I] project" 45 C.F.R. 116.17(h)(1) (1974) and not "to supplant State and local funds available for the education of such pupils" (45 C.F.R. 116.17(h)(2) (1974)).

2. The present dispute arose when auditors from the Department of Health, Education, and Welfare (now the Department of Education) determined that, during Fiscal Year 1974, 50 different school districts in the Commonwealth of Kentucky had spent $704,237 of Title I grant funds in violation of the prohibition against using Title I funds to supplant state and local funds (C.A. App. 35). At issue were federally funded classes run by these school districts for children who were not prepared to enter first or second grade. A substantial portion of the children in these classes were expected to move on to the next grade level following their year of "readiness" instruction. The auditors concluded that federal funding of the readiness classes had replaced the state and local funds that would otherwise have been spent on first or second grade for these children. C.A. App. 34-35.

The State disagreed with the auditors' recommendation, essentially on the ground that there had been no decrease in state and local funding of the schools or grade levels involved. The State took the position that this was sufficient to satisfy the supplanting prohibition and that the federal statute and regulations should not be interpreted to require maintenance of state and local funding for the particular deprived children enrolled in the Title I program. C.A. App. 35-36. After administrative review a final determination letter was issued, sustaining the auditors' findings (C.A. App. 50).

The State appealed to the Education Appeal Board, which affirmed the auditors' findings (App., *infra*, 17a-32a). The State then sought review by the Secretary, who remanded to the Board for further consideration (*id.* at 33a-35a). Following the Board's reaffirmance of its initial decision (*id.* at 36a-37a), the Secretary again considered the case. The Secretary upheld the determination that a violation of the supplanting prohibition had occurred, but he reduced to $338,034 the amount the State was required to repay.[3] App., *infra*, 38a-42a.[4]

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[3] This reduction reflected the Secretary's determination that the pupil-teacher ratio in the readiness classes (13:1) was substantially smaller than the ratio prevailing elsewhere in the State (27:1). The Secretary concluded that the children in readiness classes had therefore received some benefit beyond what they would have received from the regular program, and that a pro rata state-federal allocation of the readiness class costs, reflecting the improved pupil-teacher ratio, was an appropriate way to calculate this benefit. App., *infra*, 3a.

[4] The final amount of the refund—$338,034—represents approximately 1% of the more than $32 million in Title I funds granted to Kentucky for the year in question (App., *infra*, 19a, 42a).

3. The State appealed to the court of appeals pursuant to 20 U.S.C. 1234d and 2851. The court of appeals sustained the Secretary's interpretation of the supplanting prohibition (App., *infra*, 8a-9a (footnote omitted)):

> It cannot be said that the interpretation posited by the Secretary is "unreasonable." The statutory and regulatory prohibitions against supplanting State and local funds with Title I funds can reasonably be applied with reference to expenditures at the level of the individual educationally deprived pupil, rather than at the level of either the [local educational agency], the school, the grade, or the classroom.

Nevertheless, the court concluded that the Secretary's interpretation could not be applied retroactively to require the repayment of funds spent in violation of Title I, because "the statutory and regulatory provisions at issue were [not] sufficiently clear to apprise the Commonwealth of its responsibilities" (App., *infra*, 9a-10a). Noting that "Congress left to the discretion of the participating States the responsibility to establish programs with Title I funds" (*id.* at 11a), the court observed (*id.* at 12a-13a (footnote omitted)):

> This is not to say that the interpretation * * * posited by the Commonwealth is controlling. On the contrary, the interpretation of the Secretary governs all future dealings. We hold only that in the absence of unambiguous statutory and regulatory requirements, and in the presence of a specific grant of discretion to the Commonwealth to develop and administer programs it believes to be consistent with the intentions of Title I, it is unfair for the Secretary to assess a penalty against the Commonwealth for its purported failure to comply substantially with the requirements of law, where there is no evidence of bad faith and the Commonwealth's program complies with a reasonable interpretation of the law.

REASONS FOR GRANTING THE PETITION

Only last Term, this Court "established the right of the Federal Government to recover funds misused by the States" in the same statutory context presented here—Title I grants under the Elementary and Secondary Education Act of 1965. *Bell* v. *New Jersey*, No. 81-2125 (May 31, 1983), slip op. 17. The decision of the court of appeals effectively eviscerates that right and seriously jeopardizes the federal government's ability adequately to monitor grants-in-aid for compliance with statutory requirements. Moreover, the decision below conflicts with the decisions of other courts of appeals and potentially affects the recoupment of millions of dollars annually. For these reasons, review by this Court is warranted.

1. In *Bell* v. *New Jersey*, No. 81-2125 (May 31, 1983), this Court unanimously held that the federal government may recover misused funds "advanced as part of a federal grant-in-aid program under Title I of the Elementary and Secondary Education Act" (slip op. 1). The Court emphasized that states are required "to honor the obligations voluntarily assumed as a condition of federal funding" (slip op. 16) and that when a state "fail[s] to fulfill those assurances, * * * it [becomes] liable for the funds misused, as the grant specified" (slip op. 17).

The court of appeals acknowledged that, in light of *Bell* v. *New Jersey*, *supra*, "the federal government

has * * * the authority to recover misspent funds from states which had received grants under Title I" (App., *infra*, 4a). The court of appeals also stated that, "if supplanting occurred" here, "the Secretary has the authority to order a refund" *(ibid.)*. Finally, the court upheld as reasonable the Secretary's determination that supplanting had in fact occurred in the State during the year at issue (*id.* at 8a-9a). Despite these conclusions, however, the court of appeals denied reimbursement, holding that "it is unfair for the Secretary to assess a penalty against the Commonwealth for its purported failure to comply substantially with the requirements of law, where there is no evidence of bad faith and the Commonwealth's program complies with a reasonable interpretation of the law" (*id.* at 12a).

a. There is no justification for the court of appeals' cramped construction of the federal government's recoupment remedy. The crucial issue in a refund proceeding is whether the grant recipient has used federal funds in a manner that violates the terms and conditions of the grant statute and regulations. On that issue doubts must be resolved in favor of the administrative interpretation, not against it. Here, however, the court of appeals refused to allow recoupment despite its determination that the Secretary's interpretation of the supplanting provisions was reasonable, simply because it found that the State's interpretation was also reasonable. The court below thus ignored the controlling legal principle that a court should defer to a federal agency's reasonable interpretation of its governing statute and regulations. *Udall* v. *Tallman*, 380 U.S. 1, 16 (1965). Indeed, in view of the key role played by the Department of Education and its predecessors in developing

the Title I legislation,[5] the congressional expectation that the agency would actively enforce the statute,[6] and the expert nature of the enforcement determinations that the agency must make,[7] this is a situation in which deference to the administrative determination is particularly appropriate.

To be sure, the court of appeals announced that the Secretary's interpretation of the supplanting provisions "governs all future dealings" (App., *infra*, 12a). But this statement only highlights the anomaly of the court of appeals' ruling. Having found that the Secretary's interpretation of the statute was reasonable, the court of appeals erred in overruling the administrative decision to proceed by adjudication and in limiting the Secretary to prospective application of his interpretation. It has long been established that agencies may choose to develop interpretations of the law retroactively through adjudication rather than prospectively by rulemaking. *SEC* v. *Chenery Corp.*, 332 U.S. 194, 202-203 (1947).

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[5] When Congress first recognized that use of Title I funds to supplant state and local funds was a serious problem, it relied on information developed by the Office of Education. See S. Rep. 91-634, 91st Cong., 2d Sess. 9 (1970).

[6] In adopting the express prohibition against supplanting, the Senate Committee made clear that it expected the Commissioner of Education "to exercise fully his authority and responsibility under the law" to see that Title I funds are properly spent. S. Rep. 91-634, *supra*, at 10. Cf. *id.* at 14-15.

[7] Under the Act, "the determination of the existence and amount of the [audit] liability are committed to the agency in the first instance" (*Bell* v. *New Jersey*, slip op. 17-18). In making that determination in supplanting cases, the Secretary must review a myriad of varying state and local administrative arrangements, a task that is aided by his background and expertise in educational administration.

This is not a case in which retroactive application would produce "substantial inequitable results." *Chevron Oil Co.* v. *Huson*, 404 U.S. 97, 107 (1971) (quoting *Cipriano* v. *City of Houma*, 395 U.S. 701, 706 (1969)). The Secretary's decision did not "establish a new principle of law, either by overruling clear past precedent on which litigants may have relied or by deciding an issue of first impression whose resolution was not clearly foreshadowed" (*Chevron Oil Co.* v. *Huson*, 404 U.S. at 106 (citations omitted).[8] In any event, even if this case involved a new legal principle, the Secretary would "not [be] precluded from announcing new principles in an adjudicative proceeding * * *. [T]he choice between rulemaking and adjudication lies in the first instance within the [agency's] discretion" (*NLRB* v. *Bell Aerospace Co.*, 416 U.S. 267, 294 (1974)).

b. Although the federal government's right to recover misused grant funds is now beyond dispute, see *Bell* v. *New Jersey*, *supra*, that right would be largely theoretical under the court of appeals' approach. The decision below holds that there may be no recovery in any case in which the grant recipient can show some colorable justification for the erroneous expendi-

[8] Nothing in the record suggests that the State substantially changed its position in reliance on an authoritative contrary interpretation of the statute and regulations. In any event, a change in position would not have been reasonable. The supplanting prohibition was well known in the educational community (see *Nicholson* v. *Pittenger*, 364 F. Supp. 669, 673-674 (E.D. Pa. 1973)), and the Title I grant applications completed by each of the local Kentucky school districts and reviewed by the State contained a question clearly indicating that the prohibition required maintenance of existing state and local funding for the educationally deprived children in the program (App., *infra*, 27a). See also pages 11-13, *infra*.

ture—*i.e.*, that its "program complies with a reasonable interpretation of the law" (App., *infra*, 12a).[9] And in determining whether the grant recipient's interpretation of the governing statute and regulations was reasonable, the court of appeals appears to have contemplated an exceedingly low standard of reasonableness.

Here, for example, the court of appeals concluded that "the statutory and regulatory provisions at issue were [not] sufficiently clear to apprise the Commonwealth of its responsibilities under the Act" (App., *infra*, 9a-10a) despite overwhelming evidence to the contrary. The Secretary's focus on the level of state and local funds spent for the particular *children* in the Title I program was expressly required by the statute, which provided that federal funds must supplement non-federal funds available "for the education of *pupils* participating in [Title I] programs." 20 U.S.C. (1976 ed.) 241e(a)(3)(B)(i) (emphasis added). The statutory

[9] See also App., *infra*, 9a & n.8 ("we are concerned with the fairness of imposing sanctions upon the Commonwealth of Kentucky for its 'failure to substantially comply' with the" Act). The court of appeals misunderstood the statutory scheme in devising its "substantial compliance" test. The court relied on 20 U.S.C. 1234b(a) and 1234c(a), which authorize the Secretary to withhold grant funds and to issue cease-and-desist orders when a recipient of federal funds has failed to "comply substantially" with federal requirements. However, the provisions authorizing the Secretary to make audit determinations do not contain a "substantial compliance" standard. 20 U.S.C. 1226a-1, 1234a(e), 2835. This statutory distinction recognizes that withholding or cease-and-desist proceedings may result in immediate cessation of an ongoing program, while an audit involves only an after-the-fact adjustment of accounts. Indeed, in audit proceedings Congress specifically placed on the grantee the burden of "demonstrat[ing] the allowability of expenditures disallowed in the final audit determination." 20 U.S.C. 1234a(b).

language was made even more explicit by the Secretary's regulations, which provided (during Fiscal Year 1974) that "neither the project area *nor the educationally deprived children residing therein* will otherwise be penalized in the application of State and local funds because of such a use of funds under title I * * *. Federal funds * * * will be used to supplement * * * the level of state and local funds * * * available *for the education of pupils participating in that [Title I] project* [and] * * * will not be used to supplant State and local funds available *for the education of such pupils.*" 45 C.F.R. 116.17(h), (1) and (2) (1974) (emphasis added). And the Secretary's determination was further supported by the Education Appeal Board's finding that the State's arrangement diverted to other uses state and local funds that would otherwise have been spent on educationally deprived children participating in the Title I program—the precise evil at which the supplanting prohibition was directed.[10] Accordingly, the court of appeals' conclusion that the State's strained interpretation of this fundamental provision[11] was sufficiently justified to excuse it from the duty to repay misspent funds amounts in effect to the recognition of a "good faith" defense to the repayment obligation.

[10] The Board found that "by maintaining State and local funds at the grade level while Title I paid for instructional costs of the readiness program, the [Kentucky school districts] assured that additional State and local funds were devoted to non-Title I pupils—funds which in the absence of Title I would have paid for the instruction of the educationally deprived children" (App., *infra*, 24a). Such use of Title I funds directly violated the congressional intent that "the funds are [to be] concentrated on the priority needs of poor children and are not [to be] diverted to meeting other needs of school systems, however pressing these other needs may be" (S. Rep. 91-634, *supra*, at 10).

[11] The Board's finding (not challenged by the court of appeals) that the State used federal funds to free state and local monies for non-Title I purposes (App., *infra*, 24a) establishes that the misuse was not a mere "technical violation of the agreement" or a "violation rest[ing] on a new regulation or construction of the statute issued after the state entered the program and had its plan approved." *Bell* v. *New Jersey*, slip op. 2 (White, J., concurring). To the contrary, the State ignored the fundamental statutory purpose of insuring that federal funds enhance the educational opportunities of deprived children rather than provide general subsidies for school systems. See note 10, *supra*.

There is no reason why the Secretary's right to recoup misspent grant funds should depend upon a showing that the State acted in bad faith in its use of the funds. When Congress passed the Elementary and Secondary Education Act in 1965 and authorized recoupment of misused Title I funds, it acted against the background of numerous decisions of this Court recognizing that the federal government may recover monies improperly paid or used for an improper purpose. See *United States* v. *Wurts*, 303 U.S. 414, 415 (1938); *Grand Trunk W. Ry.* v. *United States*, 252 U.S. 112 (1920); *Wisconsin Cent. R.R.* v. *United States*, 164 U.S. 190 (1896); *United States* v. *Carr*, 132 U.S. 644 (1890); *United States* v. *Barlow*, 132 U.S. 271, 281-282 (1889); *United States* v. *Burchard*, 125 U.S. 176, 180-181 (1888). None of these cases suggests that recoupment is contingent on proof other than the erroneous nature of the payment; there is no indication that the government must also show bad faith on the part of the recipient of the funds.[12]

[12] The court of appeals incorrectly assumed (App., *infra*, 9a) that the recovery of misused grant funds would "impos[e] sanctions" or a "penalty" on the State. Grant-in-aid agreements,

Indeed, rather than supporting the implication of a "good faith" defense, Title I and its legislative history show that Congress had no intent to create such a broad exception to the State's obligation to repay misspent federal funds. In 1970, when Congress amended the Act to "make clear its intention that States return misused funds" (*Bell* v. *New Jersey*, slip op. 10), the Senate Committee recognized that "there may be difficulties arising from recovery of improperly used funds." Nevertheless, the Committee stated, "those [audit] exceptions must be enforced if the Congress is to carry out its responsibility to the taxpayers." S. Rep. 91-634, *supra*, at 84. Congress later attempted to deal with some of the "difficulties" associated with Title I audit claims by imposing a five-year statute of limitations and by authorizing the compromise of audit claims of $50,000 or less, where collection is not practical or in the public interest and the practice that resulted in the claim has been corrected. 20 U.S.C. 1234a(g) and (f). Significantly, Congress did not choose to include a "good faith" exception in this ameliorative legislation, although it was aware that the Secretary had asserted

however, are "much in the nature of a contract." *Pennhurst State School & Hospital* v. *Halderman*, 451 U.S. 1, 17 (1981). In a recoupment action, the Secretary merely attempts to recover monies that were not spent in accordance with the federal statute and regulations with which the State undertook to comply; the remedy is compensatory, not punitive. Congress has provided other remedies for the knowing misuse of federal funds. See, *e.g.*, 31 U.S.C. 3729; *United States* v. *Bornstein*, 423 U.S. 303 (1976); *Dixson* v. *United States*, No. 82-5279 (Feb. 22, 1984).

audit claims in cases of good faith dispute.[13] Such an exception should not be created by judicial fiat.

c. Finally, nothing in *Pennhurst State School & Hospital* v. *Halderman*, 451 U.S. 1 (1981), supports the court of appeals' decision. *Pennhurst* held that, absent clear and unambiguous statutory language, the Court would not assume that Congress intended to impose, as a condition of federal grants, a "massive obligation" requiring "the States to fund new, substantive rights" of "largely indetermined" scope. 451 U.S. at 18, 24. But as this Court noted in rejecting a similar contention in *Bell* v. *New Jersey*, slip op. 16 n.17, "*Pennhurst* arose in the context of imposing an unexpected condition for compliance—a new obligation for participating States—while here our concern is with the remedies available against a noncomplying State." Accordingly, there can be no question that "*Pennhurst's* requirement of legislative clarity" (*ibid.*) does not prevent the Secretary from ensuring that federal funds are spent in accordance with congressional restrictions. No grant recipient could ever have thought otherwise.

[13] Congress did authorize the Secretary to return to the states up to 75% of the repaid funds where the practices that led to the misuse have been corrected and where the returned funds will, to the extent possible, be used to benefit the population affected by the misuse and will serve to achieve the purposes of the approved state program (20 U.S.C. 1234e(a)).

The grantback provision has been exercised by the Secretary on several occasions. See, *e.g.*, 47 Fed. Reg. 20343-20345 (1982) (grantback to Wisconsin of 75% of repaid funds determined to have been misapplied by the State during the 1967-1972 audit period); 47 Fed. Reg. 23002-23003 (1982) (grantback to the District of Columbia of 75% of repaid funds misapplied during the audit period from 1973-1977).

2. The court of appeals' decision conflicts with the decision of the Fourth Circuit in *West Virginia* v. *Secretary of Education*, 667 F.2d 417 (1981). In that case, as here, the propriety of a school district's expenditure of Title I grant funds hinged on whether the Secretary or the State was correct in its interpretation of the statute and regulations. As the Fourth Circuit analyzed the case (667 F.2d at 420):

> Neither legislative history nor other decisions of the Secretary provide any clues as to what that interpretation should be. In such circumstances courts, of course, give deference to an agency's interpretation of a statute governing it and its own regulations.

The Fourth Circuit could see "no reason why that principle should not be followed in this instance" and, despite the statutory ambiguity, it upheld the Secretary's order requiring the State to refund misspent federal grant funds (*ibid.*).

Similarly, in *Indiana* v. *Bell*, 728 F.2d 938 (1984), the Seventh Circuit sustained the Secretary's finding of an audit deficiency under Title I, stating that it would "defer to agency interpretations of the statutes committed to its administration, especially where, as here, *see* 20 U.S.C. 242(b) (1982), Congress has delegated rule-making authority to the agency" (728 F.2d at 940). The Seventh Circuit's discussion suggests that at least one of the positions advanced by the State might have met the Sixth Circuit's standard of "reasonableness." Nevertheless, the Seventh Circuit upheld the Secretary's order requiring the State to refund misspent federal grant funds. *Id.* at 942 (teacher aide program).

In this case, by contrast, the court of appeals refused to decide the recoupment dispute based on "the reasonableness of the Secretary's interpretation of Title I" (App., *infra*, 9a). Unlike the Fourth and Seventh Circuits, the court below held that the State's obligation to repay misspent grant funds must be measured by "the fairness of imposing sanctions upon the Commonwealth of Kentucky for its 'failure to substantially comply' with the requirements of" the Act (*id.* at 9a & n.7 (expressly disagreeing with *West Virginia* v. *Secretary of Education*, *supra*)). This approach cannot be reconciled with the decisions of the Fourth and Seventh Circuits.

3. The court of appeals' decision, unless reversed, can be expected to have a substantial adverse impact on the Secretary's ability to recoup the approximately $68 million in currently outstanding Title I audit claims.[14] Indeed, we are informed by the Department of Education that the decision is already being routinely relied upon by the states in pending audit cases. Moreover, the decision of the court of appeals creates a substantial disincentive for Title I recipients to adhere scrupulously to the terms of federal grants in the future, because it disables the Secretary from recouping misspent funds in any debatable case.

The impact of this erroneous decision is, of course, not limited to the Title I program. Instead, it threatens to change drastically the ground rules for the audit of state and local expenditures of all federal grant funds—a figure that today stands at approximately $90 billion

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[14] Supplanting claims, which would be most directly affected by the decision below, constitute approximately $33 million of the Title I disputes.

annually. See OMB, Exec. Off. of the President, *Special Analyses, Budget of the U. S. Government, Fiscal Year 1984*, H-16 (1983). The Office of Management and Budget informs us that a survey of a sample of the major federal granting agencies, responsible for approximately 38% of the total Fiscal Year 1983 grants, shows that there are currently $830 million in audit exceptions outstanding.[15]

In effect, the court of appeals' decision invites grantees to adopt their own relaxed interpretations of federal expenditure restrictions and to resist audit exceptions whenever some interpretation can be devised to justify an erroneous expenditure. The decision thus will seriously impede the settlement of outstanding claims and, in the long run, will diminish the ability of federal agencies to enforce congressional restrictions on the use of grant funds.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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MAY 1984

[15] There are 88 cases pending before the Education Appeal Board alone, involving approximately $104 million in audit claims.

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 82-3319

COMMONWEALTH OF KENTUCKY, DEPARTMENT OF EDUCATION, PETITIONER

v.

SECRETARY OF EDUCATION, UNITED STATES DEPARTMENT OF EDUCATION, RESPONDENT

APPEAL FROM SECRETARY OF EDUCATION AND EDUCATION APPEAL BOARD.

[Filed Sept. 14, 1983]

Before: MERRITT and KENNEDY, *Circuit Judges;* WEICK, *Senior Circuit Judge.*

KENNEDY, *Circuit Judge.* The Commonwealth of Kentucky, Department of Education (Commonwealth), appeals from the March 19, 1982 decision of the Secretary of Education ordering the Commonwealth to refund $338,034.00 allegedly misspent in Title I[1] programs during 1974. For the reasons set forth below, we reverse.

The former United States Department of Health, Education and Welfare, through its Department of Health,

[1] Title I of the Elementary and Secondary Education Act of 1965 (as amended) (ESEA), 20 U.S.C. §§ 241a, *et seq.*

Education and Welfare Audit Agency (HEWAA), conducted an audit of Title I expenditures of local educational agencies (LEAs) in the Commonwealth. The period covered by the audit was July 1, 1967, through June 30, 1974, with the last phase of the audit having been concluded in September of 1974. The audit report charged *inter alia* that the Title I "readiness programs" instituted with the approval of the Kentucky Department of Education in 50 local school districts supplanted State and locally funded programs in violation of 20 U.S.C. § 241e(a)(3)(B)[2] which requires:

> Federal funds made available under this subchapter will be so *used* (i) *as to supplement* and, to the extent practical, increase the level of funds that would, in the absence of such Federal funds, be made available from non-Federal sources for the education of pupils participating in programs and projects assisted under this subchapter, *and* (ii) *in no case, as to supplant* such funds from non-Federal sources, * * * (emphasis added).

The HEWAA determination required a refund from the Commonwealth for fiscal year 1974 of $704,237.00.[3]

The Commonwealth made an application for review of this final determination in January 1977, and in the latter part of 1979 a three-member Education Appeal

[2] The "supplanting" provision was added to Title I by an amendment enacted in 1970—Pub. L. 91-230, § 109(a).

[3]
1109 (students in readiness classes in 50 LEAs expected to be promoted to the next grade level in the subsequent school year and, thus, expected to receive first or second grade credit for the time spent in the readiness program)
× $635.02 (cost per student)
$704,237.00

Board (EAB) panel was appointed to consider the matter. The Initial Decision of the EAB, issued on June 23, 1981, ruled "that the readiness programs carried out by the 50 LEAs during [Fiscal Year] 1974 were not properly designed to supplement state and local expenditures for Title I children, that a supplanting violation had occurred, and that the full $704,237.00 must be refunded by the [state educational agency] SEA to the Assistant Secretary."

Pursuant to 20 U.S.C. § 1234a(d) the Commonwealth was notified that the initial decision would become the final decision of the United States Department of Education unless the Secretary of Education, for good cause shown, modified or set aside the EAB's decision. On August 27, 1981, in response to comments and recommendations filed by the Commonwealth and the United States Assistant Secretary for Elementary and Secondary Education, the Secretary of Education, Terrel H. Bell, remanded the audit to the EAB for further consideration. Secretary Bell instructed the EAB to determine whether the amount of $740,237.00 should be reduced in view of several factors including the more favorable pupil:teacher ratio in the readiness classes (13:1) as compared with that in the regular classes (27:1).

The EAB panel affirmed its earlier decision, but 'for good cause shown' Secretary Bell on review reduced the audit figure by 52%, representing the supplemental services received by students in the Title I readiness programs as a result of the significantly smaller pupil:teacher ratio. The amount ordered to be refunded by the Commonwealth was thus reduced to $338,034.00.

I.

On appeal to this Court, the Commonwealth argues that the Secretary did not have any authority to consider and make demand for a refund of Title I funds which had purportedly been misspent in 1974. As originally enacted, the ESEA did not expressly authorize the Secretary to demand a refund of misspent Title I funds. It was not until the Education Amendments of 1978, 20 U.S.C. § 2835, that provisions were adoped authorizing audit determinations and the collection from SEAs of Title I funds found to have been misspent. Accordingly, it is argued that the Secretary exceeded his statutory authority in ordering this refund.

This argument was definitively rejected by the Supreme Court in the recent decision of *Terrell H. Bell, Secretary of Education* v. *New Jersey and Pennsylvania*, 51 U.S.L.W. 4647 (U.S. May 31, 1983) (No. 81-2125). There the Court held that the federal government has had, from the inception of the Act, the authority to recover misspent funds from states which had received grants under Title I. Eight Justices reasoned that although the authority of the Secretary to recover misspent funds did not become explicit until the Education Amendments of 1978, the pre-1978 version of ESEA contemplated that states misusing federal funds would incur a debt to the federal government for the amount misused.[4] Accordingly, if supplanting occurred, the Secretary has the authority to order a refund.

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[4] Justice White, concurring, would have preferred to have held that the 1978 amendments, which unequivocally allowed for repayments, should be applied retroactively.

II.

The Commonwealth argues in the alternative that even if the Secretary has the authority to order this refund, the record does not justify the determination that a supplanting, rather than a supplementing, of State and local funds occurred during fiscal year 1974. It is unclear what standard this Court should employ in reviewing the determination of the Secretary. As noted by Justice White in his concurring opinion in *Bell*, the cases reviewed in that decision.

> ...do *not* involve any question as to the substantive standard by which a claim that a recipient has violated its Title I commitments is to be judged. Rather, they concern the abstract question whether the Secretary has the right to recover Title I funds under any circumstances. *In my view, there is a significant issue whether a State can be required to repay* if it has committed *no more than a technical violation of the agreement* or *if the claim of violation rests on a new regulation or construction of the statute issued after the state entered the program and had its plan approved.* (emphasis added)

Id., at 4653. In the instant case, we must address this "significant issue" left open in *Bell*. The only guidance provided by the majority in *Bell* appears at p. 4652:

> [T]he States have an opportunity to litigate in the courts of appeal whether the findings of the Secretary are supported by substantial evidence and *reflect application of the proper legal standards.* § 455, 20 U.S.C. § 1234d(c); 5 U.S.C. § 706 (emphasis added).

Title I establishes financial support for LEAs to meet the special educational needs of educationally deprived

children residing in school attendance areas having high concentrations of children from low income families. Congress provided that Title I funds were to be distributed to LEAs through SEAs upon application for the funds. The Commonwealth's programs were administered through the Kentucky Department of Education. The implementing rules and regulations in effect in fiscal year 1974 reinforced the statutory requirement that Title I funds should not supplant State or local funds and should supplement those funds. 45 C.F.R. § 116.17(h) (1971) (transferred to 34 C.F.R. pt. 200) of the regulations provides in pertinent part:

> Each application for a grant under Title I of the Act for educationally deprived children residing in a project area shall contain an assurance that the use of the grant funds will not result in a decrease in the use for educationally deprived children residing in that project area of State or local funds which, in the absence of funds under Title I of the Act, would be made available for that project area and that neither the project area nor the educationally deprived children residing therein will otherwise be penalized in the application of State and local funds because of such a use of funds under Title I of the Act. No project under Title I of the Act will be deemed to have been designed to meet the special educational needs of educationally deprived children unless the Federal funds made available for that project (1) will be used to supplement, and to the extent practical increase, the level of State and local funds that would, in the absence of such Federal funds, be made available for the education of pupils participating in that project; (2) will not be used to supplant State and local funds available for the education of such pupils; and (3) will not be

> used to provide instructional or auxiliary services in project area schools that are ordinarily provided with State and local funds to children in nonproject area schools.

The Commonwealth argues that no supplanting took place when it designed self-contained readiness classrooms. The Commonwealth points out that Title I readiness classrooms were not approved by the Kentucky Department of Education unless the LEAs maintained the same number of State and locally funded regular classroom teachers as they had before the readiness programs were established. Thus, from the LEAs' standpoint they were supplementing the existing programs since their expenditures for existing regular classroom programs remained at the same level. By the same token they were not supplanting any of their existing programs or expenditures with the Title I self-contained classrooms. The Secretary counters:

> We interpret the ... regulations to mean that the advent of Title I funds shall not result in a decrease in the use of State and local support for the education of the educationally deprived children residing in the project area. The SEA officials viewed supplanting as the failure of the LEA to employ the number of non-Title I teachers that State and local funds were made available for, by school and grade, based on average daily attendance (ADA) statistics. The SEA's view does not relate to the per pupil expenditure and does not give the Title I student his fair share of services purchased with State and local funds. Further, the concept of a readiness program is to primarily prepare a child for the first grade. However, the SEA's view permits the use of the readiness class to serve as a general educational first grade.

(Report on Review of Administration of the ESEA of 1975 Title I Projects at LEAs Administered by the

Kentucky Department of Education for the Period July 1, 1967 through June 30, 1974, p. 28; JA: 34).

Thus, the Secretary focuses on the expenditure per pupil.[5]

In its initial decision the EAB wrote:

> The SEA devoted most of its evidence and much of its argument to proving that State and local fiscal effort was maintained at the school district, school and grade levels. The Assistant Secretary does not dispute this showing but considers its irrelevant, asserting that compliance must be judged with reference to State and local funds expended for the benefit of the specific pupils enrolled in readiness classes.

(Initial Decision of the EAB, June 23, 1981, at p. 8; JA: 69).

It cannot be said that the interpretation posited by the Secretary is "unreasonable."[6] The statutory and

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[5] It is interesting to note that it is the success of the program which causes the problem. It is only when the child is able to advance to the regular classroom in the next grade that repayment is required. No reimbursement is required for those children who return to the regular first grade classroom.

[6] Generally, when neither legislative history nor other decisions of the Secretary definitively interpret the language of an ambiguous statute, courts will defer to the interpretation advanced by the agency empowered to administer the statute. *See United States* v. *Larionoff*, 431 U.S. 864. 872 (1977). *See also Meade Tp.* v. *Andrus*, 695 F.2d 1006, 1009 (6th Cir. 1982) (where this Court wrote that the interpretation of a statute by the agency charged with its enforcement is entitled to "'more than mere deference or weight. (The regulation) can only be set aside if the Secretary exceeded his statutory authority or if (it) is arbitrary, capricious, or otherwise not in accordance with law.' *Batterton* v. *Francis*, 432 U.S. 416, 426, 97 S.Ct. 2399, 2406, 53 L.Ed.2d 448 (1977); 5 U.S.C. § 706(2)(A)."); *Satty* v. *Nashville Gas Co.*, 522 F.2d 850, 854 (6th Cir. 1975). *aff'd in part, vacated in part, and remanded*, 434 U.S. 136 (1977) (where this Court articulated the standard as one where "absent

regulatory prohibitions against supplanting State and local funds with Title I funds can reasonably be applied with reference to expenditures at the level of the individual educationally deprived pupil, rather than at the level of either the LEA, the school, the grade, or the classroom. Nonetheless, in the instant case we do not feel that it is our task on appeal to review the reasonableness of the Secretary's interpretation of Title I section 241e(a)(3)(B) and regulation section 116.17(h).[7] We are not reviewing with reference to the future effect of the Secretary's interpretation of a statute. Rather, in this appeal we are concerned with the fairness of imposing sanctions upon the Commonwealth of Kentucky for its "failure to substantially comply"[8] with the requirements of section 241e (a)(3)(B) and 45 C.F.R. 116.17(h), as those requirements were ultimately interpreted by the Secretary.

We disagree with the Secretary's conclusion that the statutory and regulatory provisions at issue were sufficiently clear to apprise the Commonwealth of its re-

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clear indicia in the form of legislative history that the agency interpretation is unreasonable or unnatural, we must defer to the commissioner's construction of the statute...").

[7] *Contra, State of W. Va.* v. *Secretary of Ed.*, 667 F.2d 417, 420 (4th Cir. 1981) (per curiam) (where, in resolving a dispute over ambiguity in the ESEA and regulations, the Fourth Circuit deferred to the interpretation advanced by the Secretary and affirmed the order of the Secretary requiring West Virginia to refund $125,000 misspent on the construction of an administrative office complex).

[8] *See* 20 U.S.C. § 1234b(a) and § 1234c(a) (1978) (where the Commissioner is said to act upon the belief that a recipient of funds had "failed to comply substantially" with any requirement of law applicable to such funds).

sponsibilities under the Act.[9] It cannot be inferred that the Commonwealth had notice of its obligations.[10] The

[9] In 1974, Congress adopted a further amendment to Title I, 20 U.S.C. § 241e(a)(1) (excess costs provision) in order to "re-emphasize" that Title I funds were not to be used to supplant State and local funds. H.R. Rep. No. 805, 93rd Cong., 2d Session, 17, *reprinted in* [1974] U.S. Code Cong. & Admin. News 4093, 4108. We disagree with the Commonwealth's contention that, prior to the adoption of the 'excess costs' provision, Section 241e(a)(3)(B) could not reasonably be interpreted to prohibit supplanting with reference to expenditures at the level of the individual educationally deprived student, and that, therefore, the Secretary is now attempting to retroactively enforce the 'excess costs' provision of the Act. However, the new provision makes it abundantly clear that Congress could have used language in the original enactment which would have been less ambiguous and would have more fairly apprised the State of its obligations.

[10] The Initial Decision of the EAB, June 23, 1981, pp. 8-9; JA: 69-70 concluded:

> The Panel is persuaded that *the statutory and regulatory provisions are sufficiently clear in their emphasis on the expenditure of funds for pupils*—not LEA's, schools or grade levels—to sustain the Assistant Secretary's position. Clause (B) of the statute[4] mandates the use of Federal funds to "supplement and ... increase" the level of funding that would otherwise "be made available from non-Federal sources *for the education of pupils participating* in programs and projects" assisted by Title I (emphasis added [by Board]).
>
> The regulatory provision[5] is equally clear, even to the point of repetition. It requires assurances that use the grant funds not result in a decrease "in the use *for educationally deprived children*" of the State and local funds; that "educationally deprived children" not be penalized in the application of State and local funds; that Federal funds be used to supplement non-Federal funds that would absent Title I, "be *made available for the education of pupils participating*" in Title I; and that Federal funds not supplant non-Federal funds *"available for the education of such pupils."* (emphasis added [by Board]).

[4] 20 U.S.C. § 241e(a)(3)(B)...
[5] 45 C.F.R. 116.17(h)...

legislative history to Title I is replete with evidence that Congress left to the discretion of the participating States the responsibility to establish programs with Title I funds to strengthen educational opportunities for educationally deprived children.

> Under the terms of the legislation, a local public school district may use funds granted to it for the broad purpose of programs and projects which will meet the educational needs of educationally deprived children in those school attendance areas in the district having high concentrations of children from low income families. *It is the intention of the proposed legislation not to prescribe the specific types of programs or projects that will be required in school districts. Rather, such matters are left to the discretion and judgment of the local public educational agencies since educational needs and requirements for strengthening educational opportunities for educationally deprived elementary and secondary school pupils will vary from State to State and district to district.* What might be an acceptable and effective program in a school district serving a rural area may be entirely inappropriate for a school district serving an urban area, and vice versa. There may be circumstances where a whole school system is basically a low-income area and the best approach in meeting the needs of educationally deprived children would be to upgrade the regular program. On the other hand, in many areas the needs of educationally deprived children will not be satisfied by such an approach.

S. Rep. No. 146, *reported at* [1965] U.S. Cong. & Admin. News 1446, 1454.

> It should be emphasized, ... that no suggested program is in itself mandatory upon a public school authority. The selection of an appropriate program

> or programs, for which State educational authority approval is sought, rests with the local educational agency.

Id., at 1456-57.

This is not to say that the interpretation of the statutory and regulatory requirements posited by the Commonwealth is controlling. On the contrary, the interpretation of the Secretary governs all future dealings. We hold only that in the absence of unambiguous statutory and regulatory requirements, and in the presence of a specific grant of discretion to the Commonwealth to develop and administer programs it believes to be consistent with the intentions of Title I, it is unfair for the Secretary to assess a penalty against the Commonwealth for its purported failure to comply substantially with the requirements of law, where there is no evidence of bad faith and the Commonwealth's program complies with a reasonable interpretation of the law.[11]

We find support for this position in *Pennhurst State School and Hospital* v. *Halderman*, 451 U.S. 1, 17 (1981), where the Supreme Court analyzed Congress' power to place conditions on the grant of federal funds to States under the Developmentally Disabled Assistance and Bill of Rights Act of 1975, 89 Stat. 486, as amended, 42 U.S.C. § 6000 *et seq.* (1976 ed. and Supp. III).

> Turning to Congress' power to legislate pursuant to the spending power, our cases have long recognized that Congress may fix the terms on which it shall disburse federal money to the States. See

[11] *Compare Alexander* v. *Califano*, 432 F. Supp. 1182 (N.D. Cal. 1977) (where Title I funds were found to "supplant" in violation of § 241e(a)(3)(B)).

> *e.g.*, *Oklahoma* v. *CSC*, 330 U.S. 127 (1947); *King* v. *Smith*, 392 U.S. 309 (1968); *Rosado* v. *Wyman*, 397 U.S. 397 (1970). Unlike legislation enacted under § 5 [of the Fourteenth Amendment], however, *legislation enacted pursuant to the spending power is much in the nature of a contract: in return for federal funds, the States agree to comply with federally imposed conditions. The legitimacy of Congress' power to legislate under the spending power thus rests on whether the State voluntarily and knowingly accepts the terms of the "contract."* See *Steward Machine Co.* v. *Davis*, 301 U.S. 548, 585-598 (1937); *Harris* v. *McRae*, 448 U.S. 297 (1980). *There can, of course, be no knowing acceptance if a State is unaware of the conditions or is unable to ascertain what it expected of it. Accordingly, if Congress intends to impose a condition on the grant of federal moneys, it must do so unambiguously.* (footnote omitted) *Cf. Employees* v. *Department of Public Health and Welfare*, 411 U.S. 279, 285 (1973); *Edelman* v. *Jordan*, 415 U.S. 651 (1974). By insisting that Congress speak with a clear voice, we enable the States to exercise their choice knowingly, cognizant of the consequences of their participation. (emphasis added)

Pennhurst's requirement of legislative clarity arose in the context of imposing upon participating States an unexpected condition for compliance—interpreting the act to impose a duty on the States to provide the "least restrictive treatment" possible to severely or profoundly mentally and physically handicapped individuals. *See Bell*, *supra*, at 4651-52, n.17. Declining to suppose that Congress intended to implicitly impose such an extensive obligation on participating States the Supreme Court wrote:

> Our conclusion is also buttressed on the rule of statutory construction established above, that Congress must express its intent to impose conditions on the grant of federal funds so that the States can knowingly decide whether or not to accept those funds. That canon applies with greatest force where, as here, a State's potential obligations under the Act are largely indeterminate. It is difficult to know what is meant by providing "appropriate treatment" in the "least restrictive" setting, and it is unlikely that a State would have accepted federal funds had it known it would be bound to provide such treatment. *The crucial inquiry, however, is not whether a State would knowingly undertake that obligation, but whether Congress spoke so clearly that we can fairly say that the State could make an informed choice.*

Pennhurst, supra, at 24-25 (emphasis added). *See also Board of Education of the Hendrick Hudson Central School District Bd. of Ed., Westchester County* v. *Rowley,* 50 U.S.L.W. 4925, 4933 n.26 (U.S. June 28, 1982) (No. 80-1002) (where is was held that the phrase "free appropriate public education," in the Eduction for All Handicapped Children Act of 1975, 20 U.S.C. § 1401 *et seq.*, should not be read to impose upon States the requirement to maximize the potential of handicapped children, and that even if such was Congress' intent, its failure to clearly articulate that requirement precludes an interpretation of the Act that imposes such a burden upon States receiving federal funds); and *State of Louisiana, Dept. of Health and Human Services* v. *Block,* 694 F.2d 430, 431 n.2 (5th Cir. 1982) (where *Pennhurst, supra,* and *New Jersey* v. *Hufstedler,* 662 F.2d 208 (3d Cir. 1981), *rev'd on other grounds sub nom. Terrel H. Bell, Secretary of Education* v. *New Jersey and Pennsylvania,* 51 U.S.L.W. 4747 (U.S.May 31, 1983) (No. 81-2125) were cited for the proposition that legislative clarity is required when seeking to impose a heavy, affirmative burden upon states receiving federal funds).

The statute and the regulations at issue here are concerned not only with the welfare of pupils but also with the policy that Title I programs should not impact adversely on the project area. From the practical standpoint of the school district, although there is a correlation between the number of students and classrooms and the number of teachers required, a reduction in students does not always result in a savings to the school district. Only a reduction in faculty or facilities can bring about a savings. Given a fixed number of dollars awarded to the school district, the requirement that average per pupil expenditures be transferred to the Title I classrooms, in proportion to the number of students in attendance there who are expected to advance a grade, cannot help but have an adverse impact on the funds available for the regular classroom when the number of regular classrooms and teachers cannot be reduced.

Where, as here, a determination of whether Title I funds supplant or supplement State and local funds depends upon whether the focus is on the district or the pupil, the statute and regulations cannot be said to be unambiguous. We cannot say that the Commonwealth received these funds with the "knowing acceptance" required by *Pennhurst.* The Commonwealth was unaware of the condition that the Secretary now seeks to impose.

Accordingly, we find that the Secretary was not justified in assessing a penalty against the Commonwealth for its purported failure to comply substantially with the requirements of 20 U.S.C. § 241e(a)(3)(B).

III.

The Commonwealth finally asserts that the HEWAA assessed damages through a series of estimates and that such deficiencies in the auditors' methodology renders the assessment of damages arbitrary and capricious. Having concluded that it is unfair for the Secretary to find that the Commonwealth failed to comply substantially with the requirements of Title I, we need not address the issue of what damages would be appropriate under a contrary holding.

Accordingly, the decision of the Secretary is reversed.

APPENDIX B

EDUCATION APPEAL BOARD
U.S. DEPARTMENT OF EDUCATION

Docket No. 1-(31)-77
ACN: 70005-04

Appeal of:

STATE OF KENTUCKY
TITLE I, ESEA

INITIAL DECISION

APPEARANCES: For the State of Kentucky Department of Education (the "SEA"): Edward L. Fossett, Esq., Office of Legal Services and Don Hart, Director, Division of Compensatory Education;

For the Assistant Secretary for Elementary and Secondary Education, U.S. Department of Education ("the Assistant Secretary"), Stephen Freid, Esq. and Arnold Rosenthal, Esq.

I. PROCEDURAL HISTORY

The SEA seeks review of a final audit determination made by the Assistant Secretary's predecessor, the then Deputy Commissioner for the Bureau of Elementary and Secondary Education of the U.S. Office of Education, in a final determination letter dated December 6, 1976. The final audit determination was based on a Department of Health, Education, and Welfare Audit Agency (the "HEWAA") audit of the administation of

programs funded under Title I of the Elementary and Secondary Education Act of 1965 ("Title I") in Kentucky during the period of July 1, 1967, through June 30, 1974. A final audit report was issued by the HEWAA to the SEA on October 29, 1976. The Deputy Commissioner's final determination letter sustained the findings of the final audit report with respect to certain "readiness" programs conducted during Fiscal Year 1974 and requested a refund from the SEA in the amount of $704,237.

The early procedural history of and jurisdictional basis for this appeal are set forth in this Panel's "Prehearing Conference Statement" of November 19, 1979, and "Order on Motions for Summary Judgment" of May 7, 1980.

A status call attended by the parties was held by the Panel Chairman in Washington, D.C. on June 13, 1980, to set a schedule for further proceedings.

The SEA submitted its evidentiary case in written form on August 1, 1980. The Assistant Secretary waived any filing of rebuttal evidence on September 2, 1980.

On October 22, 1980, the parties submitted a limited "Stipulation."

The SEA filed a Brief dated October 14, 1980 and a Reply Brief dated December 5, 1980. The Assistant Secretary filed a Responsive Brief dated November 14, 1980.

The SEA filed a Motion for Oral Argument on December 18, 1980, which the Panel granted over the objections of the Assistant Secretary. Oral argument was held in Washington, D.C. on January 30, 1981.

On the basis of these proceedings and the facts and arguments before it, this Panel issues its Initial Decision herein.

II. AMOUNTS IN DISPUTE

The $704,237 at issue in this appeal represents estimates of amounts spent for readiness programs in 50 different school districts ("LEAs") during FY 1974. This figure includes funds utilized both for classroom teacher salaries and supportive services. Both items are contested by the SEA as is the methodology by which the auditors arrived at the dollar amounts assigned to both items.

The amount in dispute represents less than 50% of the total of Title I funds expended for the readiness programs in FY 1974 and less than 3% of the more than $32,000,000 in Title I funds granted to the SEA for all Title I programs in Kentucky school districts during that year.

III. SUMMARY OF INITIAL DECISION

For the reasons stated below, this Panel rules that the readiness programs carried out by the 50 LEA's during FY 1974 were not properly designed to supplement state and local expenditures for Title I children, that a supplanting violation did occur, and that the full $704,237 must be refunded by the SEA to the Assistant Secretary. While the Panel has strong misgivings about the manner in which the $704,237 was calculated, it believes that a proper calculation would have resulted in a considerably higher figure. Notwithstanding that belief, the Panel rules that the amount claimed in the final determination letter of December 6, 1976 serves as an upper limit on the refund required. The Panel's uneasi-

ness about the manner in which the claim was calculated does not extend to the question of whether a supplanting violation occurred. There is ample evidence in the record to sustain that finding.

IV. TITLE I REQUIREMENTS AT ISSUE

The audit determination disallowing funds was originally based on the "supplanting" provision of the Title I statute and regulations. Despite a number of collateral legal issues raised in this proceeding, this case still turns on an interpretation of this one fundamental requirement.

The supplanting requirement was added to the Title I statute by amendment enacted in 1970.[1] Thereafter, as a condition of grants made to LEA's, it was incumbent upon the SEA to determine that

> Federal funds made available under this subchapter will be used (i) as to supplement and, to the extent practical, increase the level of funds that would, in the absence of such Federal funds, be made available from non-Federal sources for the education of pupils participating in programs and projects assisted under this subchapter, and (ii) in no case, as to supplant such funds from non-Federal sources, 20 U.S.C. 241e(a)(3)(B).

During FY 1974 both the SEA and the LEA's were also subject to the following Federal regulation:

> Each application for a grant under Title I of the Act for educationally deprived children residing in a project area shall contain an assurance that the use of the grant funds will not result in a decrease in the use for educationally deprived children residing in that project area of State or local funds

[1] Pub. L. 91-230, § 109(a).

> which, in the absence of funds under Title I of the Act, would be made available for that project area and that neither the project area nor the educationally deprived children residing therein will otherwise be penalized in the application of State and local funds because of such a use of funds under Title I of the Act. No project under Title I of the Act will be deemed to have been designed to meet the special educational needs of eductionally deprived children unless the Federal funds made available for that project (1) will be used to supplement, and to the extent practical increase, the level of State and local funds that would, in the absence of such Federal funds, be made available for the education of pupils participating in that project; (2) will not be used to supplant State and local funds available for the education of such pupils; and (3) will not be used to provide instructional or auxiliary services in project area schools that are ordinarily provided with State and local funds to children in non-project area schools. 45 C.F.R. 116.17(h).

This regulation served to implement both the statutory provision on supplanting set forth above and the separate statutory requirement that eligible Title I programs be so designed as to "meet the special educational needs of educationally deprived children."[2]

V. FINDINGS, DISCUSSION AND CONCLUSIONS

A. Findings

The facts in this case are basically uncontested, if not always persuasively documented. This Panel finds sufficient evidence in the record, much of it wholly

[2] 20 U.S.C. 241e(a)(1)(A).

uncontroverted, to support the following findings of fact:

1. The expenditures of Title I funds at issue were devoted to paying instructional salaries and administrative overhead costs associated with readiness classes in 50 LEA's during FY 1974.

2. The readiness classes were largely self-contained, consisting of school age children receiving a special educational program in lieu of the regular first, and in some instances second, grade instruction. All children enrolled in the special readiness classes were eligible Title I eductionally deprived children.

3. There were sound educational reasons for providing this special instruction in self-contained classrooms.

4. Parental acceptance of the readiness program was dependent on it being, at least potentially, a substitute for the first grade, not a pre-school year which would have added an extra year to a child's schooling in all classes.

5. *All* readiness classroom instructional salaries, and some administrative support costs, were funded with Title I, not State and local monies. Children enrolled in readiness classes did receive the same "enrichment" services (e.g. physical education, library, art and music) as children enrolled in regular first and second grade classrooms. These enrichment programs were funded entirely with State and local funds.

6. Kentucky's allocation of State funds to the 50 LEA's in question was not reduced by virtue of their participation in Title I readiness programs or their receipt of Title I funds for readiness classroom instructional salaries.

7. Five of the 50 LEA's in question filed "comparability" reports during the audit period. HEWAA auditors found no violations of the comparability requirement[3] in these five LEA's nor are violations in the other 45 LEA's alleged.

8. Office of Education management (or program) review teams visited the SEA Title I program, including readiness programs in some of the 50 LEA's, both during FY 1974 and prior years. These review teams were aware of the readiness programs being conducted and did not challenge the validity or legality of these programs. There is no evidence in the record, however, that these teams actually reviewed the fiscal arrangements under which the readiness programs were financed.

9. The $704,237 disallowed by the final determination letter was arrived at by estimation, not actual expenditure review. The HEWAA auditors estimated the average per pupil expenditure for the readiness programs, including both instructional salaries and support costs, based upon a review of figures budgeted by 16 selected LEA's. This per-pupil estimate was then multiplied by the number of pupils in the readiness classes estimated to be promoted from readiness classes into the regular school grade for the following year. This second estimate was derived from a survey questionnaire completed by readiness classroom teachers in some 65 LEA's and actual teacher interviews at only one LEA. The product of these two estimates is the $704,237 in dispute. The auditors did not disallow estimated Title I expenditures attributable to those pupils which, in the

[3] 20 U.S.C. 241e(a)(3)(C); 45 C.F.R. 116.26.

estimation of their teachers, would not be promoted to regular classes for the following year.

B. Discussion

This case turns on whether the statutory and regulatory prohibition against supplanting State and local funds with Title I funds should be measured with reference to expenditure at the level of the LEA, the school, the grade, the classroom or the individual educationally deprived pupil. The SEA devoted most of its evidence and much of its argument to proving that State and local fiscal effort was maintained at the school district, school and grade levels. The Assistant Secretary does not dispute this showing but considers it irrelevant, asserting that compliance must be judged with reference to State and local funds expended for the benefit of the specific pupils enrolled in readiness classes. If the Assistant Secretary's interpretation of the law and regulations is correct, the SEA's case must fail, since it is undisputed factually that State and local funds were not expended for the basic instructional costs of Title I readiness pupils. Indeed, by maintaining State and local funds at the grade level while Title I paid for instructional costs of the readiness program, the SEA and the LEA's assured that additional State and local funds were devoted to non-Title I pupils—funds which in the absence of Title I would have paid for the instruction of the educationally deprived children.

The Panel is persuaded that the statutory and regulatory provisions are sufficiently clear in their emphasis on the expenditure of funds for pupils—not LEA's, schools or grade levels—to sustain the Assistant Secretary's position. Clause (B) of the statute[4] mandates the

[4] 20 U.S.C. 241e(a)(3)(B), quoted in full *supra*.

use of Federal funds to "supplement and ... increase" the level of funding that would otherwise" be made available from non-Federal sources *for the education of pupils participating* in programs and projects" assisted by Title I (emphasis added).

The regulatory provision[5] is equally clear, even to the point of repetition. It requires assurances that use of grant funds not result in a decrease "in the use *for educationally deprived children*" of the State and local funds; that "*educationally deprived children*" not be penalized in the application of State and local funds; that Federal funds be used to supplement non-Federal funds that would, absent Title I, "be made available *for the education of pupils participating*" in Title I; and that Federal funds not supplant non-Federal funds" available *for the education of such pupils.*" (Emphasis added).

On the facts of this record, it is clear that there was a *decrease* in the use of State and local funds for instruction of Title I children and that they were *penalized*, at least in the fiscal sense, in the application of State and local funds.

The SEA attempts to avoid the clear language of the statute and regulations with several creative arguments. First, it would have the Panel focus on the word "available" in the statute and regulations, asserting that regular classrooms, funded with State and local funds, were at all times available to Title I children, even though not utilized by those children in the readiness classes. Carried to its logical extreme, this proposition would permit an entire school for Title I pupils only, funded with Title I monies only, so long as some

[5] 45 C.F.R. 116.17(h), quoted in full *supra*.

locally funded school remained in the community and was otherwise "available." We find no support for this use of the term. An SEA's obligation is to *use* State and local funds for Title I children, not hold them theoretically available for use.

Second, the SEA focuses on the "comparability" requirement of the statute and asserts that compliance with that provision rules out any supplanting violation. We agree with the Assistant Secretary that comparability is not dispositive of other types of supplanting violations. The comparability requirement is found at 20 U.S.C. 241e(a)(3)(C), immediately following the statutory provision discussed at length above. A clear reading of 241e(a)(3) demonstrates that clauses (A), (B) and (C) are separate and independent requirements. If compliance with (C) alone were sufficient, Congress would never have included clauses (A) and (B).[6]

Finally, the SEA argues that the auditors retroactively applied a "bright line" test derived from the "excess cost" amendment to Title I, enacted after the audit period. 20 U.S.C. 241e(a)(1). For reasons set forth in the Assistant Secretary's Brief at pp. 14-16, we conclude that the excess cost amendment did not change the supplanting prohibition of 241e(a)(e)(B) which was in effect during the audit period, and that the authority for the auditors' determination is properly found in the earlier provision.

There is some merit to the SEA's contention that it had no notice prior to the year in question of *precisely*

[6] The SEA also cites a portion of Section 7.1 of the Office of Education's Program Guide No. 44 in support of its argument that comparability is sufficient. This argument fails for the same reason, namely compliance with one limited portion of Section 7.1 is not dispositive of all possible supplanting violations.

what was required of it. It may well not be possible to equalize State and local expenditures for *each* pupil, and were this a closer case, this Panel would be inclined to sympathize with the State's predicament. However, there is evidence in the record that the SEA was more fully aware of its obligation to prevent supplanting by the LEA's than it wishes to admit in retrospect.

The standard grant application completed by each of the 50 LEA's for the year in dispute contained the following question:

> How will you organize the program to assure that children participating in the component activity will receive this Title I service *in addition to services to which they are ordinarily entitled from state and local school funds*? Stipulation, Tab B, p. 6 (Emphasis added)

Clearly, this question was designed to obtain an assurance from the LEA's that supplanting would not take place. Had the LEA's given the assurance requested and adhered to it, the SEA would have been protected from an audit of this nature. And once aware of its obligation to protect against supplanting violations, if the SEA had some uncertainty about precisely how far it had to go in an operational sense to do so, it should have sought further interpretation from the Office of Education at the time.

C. Conclusion

For all of these reasons, we conclude that the supplanting violation alleged by the auditors is properly sustained.

VI. COLLATERAL ISSUES

A. Estoppel

The SEA has produced limited evidence and has argued to the effect that Office of Education Title I re-

view teams were aware of the readiness programs in Kentucky, had never objected to them, indeed had found them praiseworthy, and thus had given "tacit approval" to them. Therefore, the SEA concludes, some "measure of estoppel" should operate against the Assistant Secretary in this case. At Oral Argument, the SEA moved the Panel to reopen the record for additional testimony with respect to the review teams if it would be helpful to the Panel.

The Federal Government has been held by the courts to be immune from the defense of estoppel in the absence of a showing of affirmative misconduct by the Government in addition to the other traditional elements of estoppel. *U.S.* v. *Ruby Co.*, 588 F.2d 697 (9th Cir. 1978). *Cert.* denied 442 U.S. 917 (1979). Since there has been no allegation of affirmative misconduct in this case, we conclude that it would be pointless to reopen the record on this point.

B. Audit Procedures

The SEA has challenged the audit procedures and accounting standards used by the HEWAA auditors. In the SEA's view, the auditors followed arbitrary and unjustifiable practices in their failure to consider program results, their use of projections based on limited samplings and available records, their use of three cumulative estimates in the calculation of damages and their inclusion of a charge for supportive services. These practices, the SEA asserts, cannot support a claim of this magnitude.

The Assistant Secretary responded that thir issue is not relevant to the issue on appeal, which is the correctness of the Deputy Commissioner's determination

that a supplanting violation took place. The Assistant Secretary asserts that, in any case, the audit was conducted properly in accordance with the auditors' purpose of determining whether Title I funds had been expended in a manner consistent with the governing statute and regulations. Further, the audit findings were based on adequate evidence even though that evidence may have been less than perfect. Finally, the Assistant Secretary submits that the question of adequacy of the evidence goes only to the issue of damages and not to the existence of a supplanting violation.

The Panel, like the SEA, is troubled by some aspects of the manner in which the audit underlying this case was conducted. The Assistant Secretary's response is somewhat too facile in so far as it suggests that the Deputy Commissioner's determinations can be completely separated from the auditors' report which forms their basis. It is not difficult to imagine a case where the quality of the underlying audit is so poor as to make it inequitable to place the burden of proof upon a state seeking to overturn the final determination letter. However, this is not such a case.

The record before us is sufficient to substantiate a finding that supplanting occurred. Given that there are few, if any, material facts in dispute in this case, it is difficult to see how irregularities in the audit procedures could completely undermine the basis for a claim. Indeed, as a discussed below, the illogic of the auditors' methodology has actually served to reduce the magnitude of the expenditures disallowed. We conclude that alleged defects in the audit, even if fully proved, were not sufficiently serious as to justify discarding the entire audit results.

C. Damages

The method by which the auditors computed the disallowance in this case is at best ironic. Having determined that supplanting had occurred, the auditors disallowed only those Title I funds estimated to have been spent on children projected for promotion in the ensuing year from the readiness class to their regular grade. In other words, if a six year old readiness enrollee was expected to be in a regular second grade class at age seven, exception was taken. If instead, he or she was expected to continue in the readiness program for another year, or to start regular grade one in the second year, no exception was taken. This distinction presumably rests on the belief that a child promoted lost his entitlement to State and local funding for the first grade forever, whereas the entitlement of one held back was only deferred until the next year.[7]

We find nothing in the statute or regulations to justify this distinction. If Title I funds must supplement, not supplant, State and locally funded instruction to which a Title I child of school age is entitled under State law, they must do so in the current year; Title I grants to LEA's are for a one year term, and all grant requirements imposed by statute must be fulfilled during that term. Supplanting occured, and it occurred with respect to all of the readiness enrollees in the 50 LEA's, not just those promoted.

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[7] Alternatively, this distinction was merely a means of "rough justice" applied by auditors desiring to give the SEA some credit for a successful program and minimize the amount of the disallowance.

That said, the SEA's objections to the $704,237 figure pale somewhat in significance. The LEA asserts that the auditors' calculations should have been based on actual, not estimated expenditures and promotions; that no disallowance should have been taken for administrative costs since the children were eligible Title I pupils; and that some offset or credit should have been computed for those State and locally funded services which the Title I readiness enrollees did enjoy (enrichment classes, plant and equipment, etc.).

As the Assistant Secretary repeatedly argues, *actual* expenditure data is in the hands of the SEA and LEA's concerned. At no time did the SEA come forward with an alternative calculation to prove that the disallowance could be reduced by use of the actual data. Nor are we convinced that it was unreasonable to disallow Title I overhead costs in proportion to the disallowed instructional salaries which they supported. If the readiness pupils were penalized in the application of State and local funds for instruction, they were no less penalized in the application of supportive service funding. The total cost of the programs which constituted the supplanting violation properly includes overhead costs paid with Title I funds.

With respect to a credit or offset to reflect the fact that some State and local effort did benefit Title I children, we concur with the Assistant Secretary that the auditors have some discretion in calculating damages for a supplanting violation and that the discretion was not abused here. Had they not already waived any repayment for funds attributable to those children not promoted, the auditors might well have used a different method to calculate the disallowance.

In the absence of any alternative computation having been submitted and supported by the SEA, we conclude that $704,237 is the appropriate amount to be refunded. The SEA argued repeatedly that this calculation "rewarded failure and penalized success." To the extent that supplanting occured with respect to all children, not just those promoted, we submit that the auditors' peculiar methodology excused a substantial portion of the noncompliance.

VII. COMMENTS AND RECOMMENDATIONS ON INITIAL DECISION

This Initial Decision of the Panel requiring the SEA to repay $704,237 shall become the final decision of the Secretary of Education 60 calendar days from receipt hereof unless modified or set aside by the Secretary pursuant to 34 C.F.R. 78.82. Each party shall have 15 calendar days from receipt hereof to file written comments and recommendations on this Initial Decision with the Board Chairperson pursuant to 34 C.F.R. 78.82.

EDUCATION APPEAL BOARD PANEL

/S/ Robert J. Saner II

ROBERT J. SANER II, *Chairman*
DR. LAURENCE B. DEWITT
DR. ROBERT MILLER

Date: JUNE 23, 1981

APPENDIX C

EDUCATION APPEAL BOARD
U.S. DEPARTMENT OF EDUCATION

Docket No. 1-(31)-77
ACN: 7005-04

Appeal of:
STATE OF KENTUCKY
Title I, ESEA

DECISION OF THE SECRETARY OF EDUCATION

The Secretary of Education has received the comments of the State of Kentucky on the Education Appeal Board Hearing Panel's initial decision which upheld the final audit determination issued by the Deputy Commissioner for Elementary and Secondary Education that, as a result of improper use of Title I funds during fiscal year 1974, the State is required to refund the amount of $704,237. This decision was issued on June 23, 1981 and received by the State of Kentucky on June 29, 1981.

The Secretary has carefully reviewed the record in this case, including the initial decision dated June 23, 1981, the comments of the State of Kentucky dated July 19, 1981, the comments of the Assistant Secretary for Elementary and Secondary Education dated July 10, 1981, responsive comments and recommendations of the State of Kentucky dated July 27, 1981 and the responsive comments of the Assistant Secretary for Elemen-

tary and Secondary Education dated July 24, 1981. In addition, the Secretary has carefully reviewed the statutory and regulatory provisions governing the administration and use of funds in Title I programs.

The Secretary acknowledges the excellent work of the Education Appeal Board in analyzing the materials presented in light of the governing law and in rendering its thoughtful decision of June 23, 1981. The Secretary further expresees appreciation for the excellent participation by the State of Kentucky and the Assistant Secretary for Elementary and Secondary Education and their respective advocates before the Education Appeal Board. Based upon his review of the initial decision, the record in this case, the memoranda furnished by the respective parties and the governing statutory and regulatory provisions, there is hereby issued the following.

DECISION OF THE SECRETARY.

1. The case is remanded to the Education Appeal Board for further consideration of the extent, if any, to which the $704,237 which the Board determined should be refunded should be reduced in light of the following considerations.

2. From the record, it appears that the pupil/teacher ratio in the "readiness" classes was significantly lower than in the regular State and locally funded classes. If this is the case, it appears that the Title I programs involved in this audit provided some supplemental service in terms of reduced pupil/teacher ratios.

3. It is understood that the long-standing policy of the Department of Education has been to allow for children to be pulled out of the regular classroom to receive Title I instruction without viewing such limited replacement as "supplanting" if the "pullout" was for a small portion of the normal school day, month, or year. Thus, the Education Appeal Board is hereby requested to consider whether the current Title I regulatory provision (34 CFR 200.94) is a codification of this policy and whether, either as a result of the policy or as a result of a regulatory codification of this policy, the State of Kentucky should be given credit for 25% or some other percentage of the "pull-out" instruction involved in this audit in lieu of being charged with damages for 100% of the time the Title I children were removed from the regular classroom.

4. The Education Appeal Board is urged to seek additional evidence and arguments of the Assistant Secretary for Elementary and Secondary Education and the State of Kentucky in determining the effects, if any, of the foregoing considerations.

Dated this 27th day of August 1981.

/s/ T. H. BELL

T. H. BELL
Secretary

APPENDIX D

EDUCATION APPEAL BOARD
U.S. DEPARTMENT OF EDUCATION

Docket No. 1-(31)-77
ACN: 70005-04

Appeal of:
STATE OF KENTUCKY
TITLE I, ESEA

ORDER AFFIRMING INITIAL DECISION

On June 23, 1981, this Panel issued its Initial Decision in this matter, finding that a supplanting violation had occurred, and ordering a refund in the amount of $704,237 by the State of Kentucky to the U.S. Department of Education.

By Decision of the Secretary of Education dated August 27, 1981, the matter was remanded to the Education Appeal Board for further consideration. By Order dated September 23, 1981, this Panel invited the parties to submit supplemental briefs addressing two issues raised by the Secretary in his Decision.

Supplemental briefs were filed by both parties. After thorough consideration of those supplemental briefs, and its own review of the record upon which our Initial Decision was based, this Panel finds no legal basis upon which to modify its Initial Decision which is HEREBY AFFIRMED.

In its Order of September 23, 1981 inviting supplemental briefs, this Panel stated as follows:

> "Finally, in the event that the Panel, upon further consideration, finds no legal authority to modify its Initial Decision, the parties may wish to address the question of whether the Secretary has any inherent equitable powers, not available to this Panel or the Board, to reduce the claim in question. This Panel will transmit to the Secretary any arguments submitted by the parties on this issue."

The Supplemental Brief of the Assistant Secretary for Elementary and Secondary Education addressed that question, and the relevant portion of the Assistant Secretary's Supplemental Brief is appended hereto for consideration of the Secretary. The Supplemental Brief of the Commonwealth of Kentucky did not address the issue.

EDUCATION APPEAL BOARD PANEL

/s/ ROBERT J. SANER II,

ROBERT J. SANER II;
Chairman
DR. LAURENCE B. DEWITT
DR. ROBERT MILLER

DATE: January 5, 1982

APPENDIX E

U.S. DEPARTMENT OF EDUCATION
THE SECRETARY
WASHINGTON, D.C. 20202

Education Appeal Board—State of Kentucky
Docket No. 1-(31)-77, Audit Control No. 70005-04

Decision of the Secretary of Education

On June 23, 1981, the Education Appeal Board issued its initial decision on the appeal of the Commonwealth of Kentucky, disputing a final audit determination that the amount of $704,237 was misspent in Title I programs during 1974. The Board upheld the audit exception and concluded that $704,237 is the appropriate amount to be refunded. In response to that decision, further memoranda were filed on behalf of the Commonwealth of Kentucky and the Assistant Secretary for Elementary and Secondary Education.

On August 27, 1981, a decision of the Secretary was issued remanding the case to the Education [A]ppeal Board for the conduct of further proceedings. The Education Appeal Board was specifically directed to consider whether the amount of the audit exception should be reduced as a result of either reduced pupil/teacher ratios in the "readiness" classes which gave rise to the audit exceptions or the current policy of the Department to allow a limited "pullout" of students for Title I instruction.

On September 23, 1981, the panel of the Education Appeal Board invited the parties to submit additional briefs. Additional briefs were filed by the parties and, on January 5, 1982, the Education Appeal Board Panel

affirmed its initial decision of June 23, 1981. The January 5, 1982 decision of the Panel does not address either of the specific questions indicated in the August 27, 1981 decision of the Secretary. Subsequent to the order affirming the initial decision, both parties have submitted additional briefs to the Secretary of Education.

Among other issues, these briefs have discussed the question of whether the reduction in pupil/teacher ratio for students in the readiness classes constituted a supplemental service and whether, by reason thereof, the audit exception should be reduced. In the supplemental brief of the Assistant Secretary, filed on February 19, 1982, counsel address this question:

> The Assistant Secretary does not dispute that the readiness classes had more favorable pupil/teacher ratios than the regular school programs, or that the Title I children may have received some supplemental benefit as a result of this reduced ratio. (Supplemental brief at page 3).

The February 2, 1982, supplemental brief of the Assistant Secretary further discusses the specific pupil/teacher ratios. The brief concedes that the pupil/teacher ratio in readiness classes was approximately 13 to one. It further concedes that "... a pupil/teacher ratio of 27-1 is the basis for the funding of classroom units under Kentucky's State Foundation Program." (Supplemental brief at page 4). On the following page, the brief concedes that "Title I funds could have been used to pay for 14/27 (or 52%) of the [ ] cost of the readiness classes, ..."

The Assistant Secretary takes a position, however, that the ratio of 14/27 or 52 percent should be applied to the total cost of $1,650,000 rather than the $704,237

which is in dispute in this proceeding. The application of this ratio or percentage to the entire cost of the readiness program ignores both the nature of the program and the extent and basis of the audit exception.

It is clear from the audit report that the auditors expressed concern over the entire readiness program in that it seems to have replaced normal first and second grade education. On page 27 of the report, the auditors state:

> Based on an average budgeted per pupil expenditure, approximately $704,237 (including $79,377 at ineligible school attendance areas) was incurred for educational services provided to 1,109 Title I students who, as a result of the Title I program, did not receive appropriate State and local support.

In its initial decision of June 23, 1981, at page three, the Panel acknowledges that $704,237 is at issue in the appeal. However, the Panel expressed its opinion or belief that "... A proper calculation would have resulted in a considerably higher figure." Questions concerning any amount in excess of $704,237 were not before the panel and were not addressed by the Commonwealth of Kentucky. It is clear both from the auditors findings and the initial decision of the panel that the disallowance was based on students who successfully completed the readiness program and were promoted to the next grade. At page seven of the initial decision, the panel stated:

> The auditors did not disallow estimated Title I expenditures attributable to those pupils which, the estimation of their teachers, would not be promoted to regular classes for the following year.

It is clear that if the factor of 48 percent (representing the ratio of children promoted) were applied to the entire cost of the readiness program, the resultant amount would be in excess of the $704,237 at issue in this appeal. In fact, the auditors found that only $704,237 was misspent. The auditor decision to allow expenditure of more than $900,000 had nothing to do with the pupil/teacher ratios. It was based on the premise that the children who were not promoted would still receive a State and locally funded education for the school grade in which they had been enrolled in the Title I readiness program. If the allowance of costs in excess of $900,000 in the readiness programs had been based on pupil/teacher ratio, than it would be improper to further consider the pupil/teacher ratio as a basis for further reduction. It is abundantly clear from the proceedings and memoranda, that this is not the case.

There is a dearth of information in the record concerning several factors which might have a bearing on the final resolution of this case. It is not possible to determine the relative costs incurred by the respective local education agencies in conducting the Title I readiness classes and non Title I classes. It appears that the students in the readiness classes received significant benefits which were supported by State and local expenditure of funds. These benefits include transportation, health services, library services, physical education, music and art. It is also apparent that the conducting of the readiness classes without a reduction in the personnel for non Title I classes probably resulted in reduced pupil/teacher ratios for the regular classes. Detailed information on these factors is not

available in the record and it does not appear to be in the best interests of anyone to reopen or remand this matter for the receipt of still further evidence and argument.

Therefore, acting pursuant to Section 452 (d) of the General Education Provisions Act, and for good cause shown as set forth above, I modify the decision of the Education Appeal Board and reduce the audit exception by 52 percent. This percentage represents the supplemental services received by students in Title I readiness programs as a result of the significant reduction in pupil/teacher ratio from 27 to one to 13 to one. Accordingly, the amount to be refunded by the Commonwealth of Kentucky is reduced from $704,234 to $338,034.

This decision shall become final 60 days from the date hereof.

Dated this 19 day of March, 1982.

/s/ T. H. BELL

T. H. BELL

APPENDIX F

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 82-3319

COMMONWEALTH OF KENTUCKY, DEPARTMENT OF EDUCATION, PETITIONER

v.

SECRETARY OF EDUCATION, UNITED STATES DEPARTMENT OF EDUCATION, RESPONDENT

[Filed Sept. 14, 1983]

JUDGMENT

Before: MERRITT and KENNEDY, *Circuit Judges;* and WEICK, Senior Circuit Judge.

ON PETITION TO REVIEW a decision of the Secretary of Education and Education Appeal Board.

THIS CAUSE came on to be heard on the transcript of record from the said Agency and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this court that the decision of the said Agency in this cause be and the same is hereby reversed.

Each party to bear its own costs on this appeal.

ENTERED BY ORDER OF THE COURT

/s/

JOHN P. HEHMAN,
Clerk

Issued as Mandate: December 13, 1983

APPENDIX G

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 82-3319

COMMONWEALTH OF KENTUCKY, DEPARTMENT OF EDUCATION, PETITIONER

v.

SECRETARY OF EDUCATION, UNITED STATES DEPARTMENT OF EDUCATION, RESPONDENT

[Dec. 5, 1983]

ORDER

Before: MERRITT and KENNEDY, Circuit Judges; WEICK, Senior Circuit Judge.

The Court not having favored rehearing en banc in this case, the petition[] for rehearing is referred to our panel for disposition.

Upon consideration, IT IS ORDERED that the petition for rehearing be and hereby is DENIED.

ENTERED BY ORDER OF THE COURT

/s/ JOHN P. HEHMAN

Clerk

RESPONDENT'S

BRIEF

No. 83-1798

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1983

SECRETARY OF EDUCATION, UNITED STATES DEPARTMENT OF EDUCATION - - - - - - - - - Petitioner

versus

COMMONWEALTH OF KENTUCKY, DEPARTMENT OF EDUCATION - - Respondent

On Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

BRIEF FOR RESPONDENT IN OPPOSITION

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COUNTERSTATEMENT OF THE QUESTION PRESENTED

Whether the Sixth Circuit Court of Appeals was correct in deciding Kentucky was entitled to have a claim that it had violated its Title I commitments judged against a substantive standard of substantial compliance.

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October Term, 1983

No. 83-1798

SECRETARY OF EDUCATION, UNITED STATES DEPARTMENT OF EDUCATION - - - *Petitioner*

v.

COMMONWEALTH OF KENTUCKY, DEPARTMENT OF EDUCATION - - - - - *Respondent*

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

The Commonwealth of Kentucky, Department of Education, responds to the Petition for Writ of Certiorari filed on behalf of the Secretary of Education, United States Department of Education.

OPINION BELOW

The opinion of the United States Sixth Circuit Court of Appeals is styled Com. of Ky., Dept. of Educ. v. Secretary of Educ., 717 F. 2d 943 (1983).

JURISDICTION

Respondent accepts petitioner's statement of the jurisdictional facts.

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Respondent agrees that Title I of the Elementary and Secondary Education Act of 1965, 20 U.S.C. (1976 ed.) § 241e(a)(3)(B) and 45 C.F.R. 116.17(h) (1974) are the primary provisions involved in this matter presently before this Court. These provisions have been accurately set forth in the petition.

COUNTERSTATEMENT OF THE QUESTION PRESENTED

Whether the Sixth Circuit Court of Appeals was correct in deciding Kentucky was entitled to have a claim that it had violated its Title I commitments judged against a substantive standard of substantial compliance.

COUNTERSTATEMENT OF THE CASE

Petitioner's "Statement" is substantially correct. In addition, a brief detailing of the pertinent factual as well as legally historical underpinnings of the controversy of the United States Secretary of Education with the Commonwealth of Kentucky's Department of Education follow.

Title I of the Elementary and Secondary Education Act (ESEA) of 1965 established financial support to Local Educational Agencies (LEAs) to meet the special educational needs of educationally deprived children residing in school attendance areas having high concentrations of children from low income families. The amount of aid to be received by an LEA was determined on a formula basis, the key factor

being the number of children from low income families living in a district.

The legislative history of Title I reveals the intent of Congress was to place full responsibility with Local Educational Agencies and State Educational Agencies (SEAs) to develop programs to meet the needs of educationally deprived children. This Court determined in *Wheeler* v. *Barrera,* 417 U. S. 402, 406 (1974), that "Under the administrative structure envisioned by the Act, the primary responsibility for designing and effectuating a Title I program rests with . . . the 'Local Educational Agencies' ".

It was the exercise of the responsibility to design and effectuate Title I programs that got Kentucky on the way to being at odds with the Secretary of Education. The Title I funds at issue in this proceeding were expended for so-called "readiness classes" in fifty Local Educational Agencies (LEAs) in Kentucky during fiscal year 1974. These classes were designed to provide children with the background and experience they needed to start learning. The readiness classes were largely self-contained and consisted of school age children who received a special educational program rather than the regular first, and in some instances, second grade instruction. The self-contained classroom procedure was developed in Kentucky because of the belief that these children selected for the readiness programs would not do well with traumatic changes in environment. It was believed to subject these children to two types of classrooms—that for the readiness

programs and that of the regular first grade—would have been grossly detrimental to their educational progress. The self-contained procedure was however accompanied with so-called enrichment programs such as music, art, physical education and library and guidance services outside of their special classroom and special teacher. The salaries of the readiness classroom teachers were paid from Title I funds; the entire cost of the enrichment program was paid from state and local funds. Important is the fact that the pupil/teacher ratio in the readiness classes was approximately 13 to 1 instead of the usual pupil/teacher ratio of 27 to 1 under the Commonwealth's Minimum Foundation Program. It stands beyond questioning that all of the children who were enrolled in the special readiness classes were rightfully eligible Title I educationally deprived children.

The Educational Appeal Board's Initial Decision ruled "that the readiness programs carried out by the fifty LEAs during FY 1974 *were not properly designed* to supplement state and local expenditures for Title I children, that a supplanting violation did occur. . . ." (Emphasis added).

ARGUMENT FOR DENYING THE PETITION

The Sixth Circuit Court of Appeals Was Correct in Deciding That Kentucky Was Entitled To Have a Claim That It Had Violated Its Title I Commitments Judged Against a Substantive Standard of Substantial Compliance.

The petitioner has offered basically three reasons the Petition for Writ of Certiorari should be granted,

none of which, upon careful scrutinizing of the Sixth Circuit's holding, may be justifiably argued or be considered to have merit. The petitioner's first argument is that the Sixth Circuit's decision "effectively eviscerates" or at least "cramps" the federal government's recoupment remedy. The second argument is that the Sixth Circuit's decision is in conflict with decisions of the Fourth Circuit Court of Appeals and the Seventh Circuit Court of Appeals. The third argument is that the Sixth Circuit's decision will have a substantial adverse impact on outstanding Title I audit claims.

The respondent must concede, as was done at oral argument in the Sixth Circuit, that this Court's decision in *Bell* v. *New Jersey*, —— U. S. ——, 76 L. Ed. 2d 312 (1983) was dispositively against the first argument advanced to the Sixth Circuit on appeal from the Secretary of Education's finding against the Kentucky Department of Education. That is, it is now clear that if supplanting occurred in Kentucky's Title I program, the Secretary has the authority to order a refund.

However, the respondent has from the beginning of this matter also argued that there was at no time any supplanting of Title I funds in Kentucky. The Sixth Circuit recognized the Commonwealth's alternative and residual argument not disposed of by the *Bell* v. *New Jersey* decision, *supra*, rendered by this Court just two weeks before oral argument of the present case in the Sixth Circuit. The Sixth Circuit stated Kentucky's argument this way:

> "The Commonwealth argues in the alternative that even if the Secretary has the authority to order this refund the record does not justify the determination that a supplanting, rather than a supplementing of State and Local Funds occurred during fiscal year 1974." 717 F. 2d at 945.

The Sixth Circuit Opinion went on to recognize that this alternative argument required the Court to face the appropriate substantive standard against which an alleged violation of Title I requirements must be judged. See 717 F. 2d at 945. This substantive standard question "left open in *Bell*" had been highlighted by Justice White in his concurring opinion in that case, and the Sixth Circuit quoted and emphasized portions of Justice White's opinion regarding this point. See 717 F. 2d 945. Justice White stated in *Bell* v. *New Jersey, supra,* as quoted by the Sixth Circuit:

> ". . . [these cases] do *not* involve any question as to the substantive standard by which a claim that a recipient has violated its Title I commitments is to be judged. Rather, they concern the abstract question whether the Secretary has the right to recover Title I funds under any circumstances. *In my view, there is a significant issue whether a State can be required to repay* if it has committed *no more than a technical violation of the agreement or if the claim of violation rests on a new negulation or construction of the statute issued after the state entered the program and had its plan approved.*" (Emphasis in the original).

The petitioner's first argument has ignored the fact the Sixth Circuit proceeded to develop and then consider this present case against an appropriate substantive standard. Rather the petitioner has attempted to persuade this Court that what the Sixth Circuit did was to go against the application of the usual rule that provides for deference to the interpretation of a statute advanced by the agency empowered to administer the statute. However, the Sixth Circuit explicitly stated in this regard:

> "Nonetheless, in the instant case we do not feel that it is our task on appeal to review the reasonableness of the Secretary's interpretation of Title I section 241e(a)(3)(B) and regulation section 116.17(h)." 717 F. 2d at 947 (f.n. omitted).

The Sixth Circuit went on saying:

> "We are not reviewing with reference to the future effect of the Secretary's interpretation of a statute. Rather, in this appeal we are concerned with the fairness of imposing sanctions upon the Commonwealth of Kentucky for its 'failure to substantially comply' with the requirements of section 241e(a)(3)(B) and 45 C.F.R. 116.17(h), as those requirements were ultimately interpreted by the Secretary." *Id.* (f.n. omitted).

The substantive standard developed by the Sixth Circuit against which the claim that Kentucky had violated its Title I commitments was to be judged was one of "fairness." As a part of this standard comes the consideration of substantial compliance. The Court

determined in view of, among other things, key legislative history of Title I which indicates program discretion was intended to be left with local public educational agencies, and this Court's first decision in *Pennhurst State School and Hospital* v. *Halderman,* 451 U. S. 1 (1981), relative to the requirement of legislative clarity, "that the Secretary was not justified in assessing a penalty against the Commonwealth for its purported failure to comply substantially with the requirements of 20 U.S.C. § 241e(a)(3)(B)." 717 F. 2d at 950.

The petitioner's first argument is dependent upon a rejection of the role of a substantive standard for review of alleged violations of Title I requirements. The petitioner's focus is that the Secretary of Education's interpretation of supplanting provisions is reasonable; that deference must be given to that interpretation; and that if the Secretary determines a State has acted outside of that interpretation of law, the consideration of the matter is at an end. To the extent that the Sixth Circuit would add to this a substantive standard by which a claim that a recipient has violated its Title I commitments is to be determined, the petitioner argues that such a requirement cramps the construction of the federal government's recoupment remedy. If "cramping" comes from the Sixth Circuit saying a state recipient of Title I funds is entitled to have its alleged violation of law considered against a substantive standard rooted in "fairness," let the cramping begin. The use of such a substantive standard for review does not create a condition which will disallow recovery of alleged misuse of grant funds. Nothing in the Sixth Circuit's opinion supports the assertion that a State need only show some "colorable justification for the erroneous expenditure." "Colorable justification" was not the standard used by the Sixth Circuit and certainly is not equivalent to the "substantial compliance" standard the Court did use. It is believed the petitioner complaineth too much about what the Sixth Circuit decision has done to the federal recoupment remedy.

The second reason advanced by the petitioner for granting the writ of certiorari is purportedly the conflicts in federal appellate court decisions. Petitioner cites *State of W. Va.* v. *Secretary of Ed.,* 667 F. 2d 417 (4th Cir. 1981) and *Indiana* v. *Bell,* 728 F. 2d 938 (7th Cir. 1984) in an effort to illustrate this point.

Both the *West Virginia* and *Indiana* federal appellate cases were decided on the principle that deference should be given to an agency's interpretation of a statute governing it and its own regulations. The Sixth Circuit clearly understands and accepts this interpretation of statutes principle. See 717 F. 2d at 946, f.n. 6. However, as was pointed out in response to petitioner's first argument above, the Sixth Circuit particularly declared it was *not* going to consider and decide this case on the "reasonableness" of the Secretary's interpretation of the law. See 717 F. 2d at 947. Instead, as the Sixth Circuit had forecast earlier in its decision, it addressed the "significant issue" of the

"standard this Court should employ in reviewing the determination of the Secretary." 717 F. 2d at 945. The giving of deference to an agency's interpretation of a statute and the considering of the substantive standard a State's actions are going to be measured against are two different legal exercises. Neither the *West Virginia* case nor the *Indiana* case cited by the petitioner attempted to address the substantive standard issue. Therefore, these two decisions are inapposite to the case at bar and cannot reasonably be said to be in conflict with the Sixth Circuit's decision which did decide the case only after reflection upon the substantive standard by which a claim that a state has violated its Title I commitments may be judged.

Lastly, the petitioner desires to have this Court grant the petition for writ of certiorari on the speculative information outside the record that the Sixth Circuit's decision "can be expected" to have an adverse impact on not only Title I cases pending, but even to other federal grant fund programs as well. Such assertion is pure sophistry. The petitioner's suggestion that the Sixth Circuit's decision has created a "substantive disincentive for Title I recipients to adhere scrupulously to the terms of federal grants in the future, because it disables the Secretary from recouping misspent funds in any debatable case" (petition at 17) belies belief and is more than mildly offensive. The subtlety involved in such assertion is that States will be less than honest in handling federal grant programs if there is room to believe such action

can be gotten by with. Suffice it to say States are not crooks waiting for their chance to be dishonest.

States are, however, serious about providing programs that will be of educational benefit to deprived children from low income areas. In so doing, there always exists the chance that a claim will be made after the fact that a program has not in every technical respect been in full compliance with the Secretary of Education's interpretation of the applicable laws and promulgated regulations. The Sixth Circuit has determined that a substantive standard of review in such situations should be one founded on fairness. This standard is one of substantial compliance and as relates to the question left open in *Bell* v. *New Jersey, supra,* is consistent with Justice White's concurring opinion in that case. A standard of substantial compliance will allow a court to determine "whether a State can be required to repay if it has committed no more than a technical violation of the agreement or if the claim of violation rests on a new regulation or construction of the statute issued after the State entered the program and had its plan approved." *Bell* v. *New Jersey,* 76 L. Ed. 2d at 329, Justice White concurring. A substantial compliance standard of review is not a relaxed interpretation of federal expenditure restrictions. It is a standard of simple fairness. The petitioner's argument to the contrary serves no justifiable basis for granting certiorari in this case.

CONCLUSION

The petitioner has failed to offer any justifiable reasons for the petition for writ of certiorari being granted and it should therefore be denied.

Respectfully submitted,

DAVID L. ARMSTRONG
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Counsel for Respondent

CERTIFICATE OF SERVICE

I, Robert L. Chenoweth, counsel for respondent, hereby certify that the foregoing Brief in Opposition was served on petitioner by depositing three copies of same in the United States mail, first class postage prepaid, on June 11, 1984, addressed to counsel for petitioner, Honorable Rex E. Lee, Solicitor General, U. S. Department of Justice, Washington, D. C. 20530.

Robert L. Chenoweth

ROBERT L. CHENOWETH

REPLY

BRIEF

No. 83-1798

In the Supreme Court of the United States

OCTOBER TERM, 1984

TERREL H. BELL, SECRETARY OF EDUCATION,
PETITIONER

v.

COMMONWEALTH OF KENTUCKY,
DEPARTMENT OF EDUCATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

REPLY MEMORANDUM FOR THE PETITIONER

REX E. LEE
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

TABLE OF AUTHORITIES

In the Supreme Court of the United States

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No. 83-1798

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REPLY MEMORANDUM FOR THE PETITIONER

Respondent defends the decision of the court of appeals on the basis that it merely applied a "substantial compliance" test and concluded that while a violation of the Act and regulations (as reasonably interpreted by the Secretary) did occur, the violation was "technical" rather than substantial. See *Bell* v. *New Jersey*, No. 81-2125 (May 31, 1983) (White, J., concurring).

This argument misses several points. First, the "substantial compliance" test, as set forth in the Act, does not apply to recoupment of funds following an audit deficiency. Second, even if the test were applicable, respondent has misconceived the nature of "substantial compliance." The generally accepted meaning of the term refers to the significance of the provision that has been violated. In this case

there was a violation of a provision of the Act that plays a crucial role in implementation of the congressional purpose. Such a violation is not merely "technical" and is totally inconsistent with any test of "substantial compliance." In any event, the court of appeals did not apply a substantial compliance test: it did not hold that the State was in substantial compliance with the proper (*i.e.*, the Secretary's) interpretation of the relevant statutory and regulatory requirements. Instead, contrary to controlling legal principles, the court deferred to the State's interpretation of statutory and regulatory provisions it found to be ambiguous.

1. As we pointed out in the petition (at ll n.9), the Secretary is authorized to withhold grant funds and to issue cease-and-desist orders when a recipient of federal funds has failed to "comply substantially" with federal requirements (20 U.S.C. 1234b(a), 1234c(a)). No such language occurs in the provisions regarding audit determinations; indeed, Congress placed on the grantee the burden of "demonstrat[ing] the allowability of expenditures disallowed in the final audit determination" (20 U.S.C. 1234a(b); see also 20 U.S.C. 1226a, 2835). This distinction reflects the fact that withholding or cease-and-desist orders can be expected to stop an ongoing program, while audit determinations are after-the-fact adjustments of account. In the case of audit determinations, Congress has created two "safety valve" procedures to alleviate the consequences of certain recoupments; the courts should not read into the Act an additional basis — particularly one as amorphous as "fairness" (Br. in Opp. 7) — for excusing audit deficiencies.[1]

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[1]The petition (at 15 n.13) describes the procedure under which 75% of the recouped funds may be granted back to the state under certain circumstances. 20 U.S.C. 1234e(a). In addition, Congress has authorized the compromise of audit claims of $50,000 or less where collection is not practical or in the public interest, and the practice that resulted in the claim has been corrected. 20 U.S.C. 1234a(f).

2. Even if the "substantial compliance" test were applicable, it would not operate to excuse the audit deficiency in this case. Respondent suggests that "substantial compliance" occurs whenever the statutory provision involved can be interpreted in a manner that would result in the conclusion that no violation occurred, even though the contrary interpretation prevails. Under this view, a state will be in "substantial compliance" whenever it adopts a colorable interpretation of the statutory provision in question, and only totally unambiguous provisions will require strict compliance.

However, the accepted meaning of "substantial compliance" does not involve the clarity (or lack of clarity) of the statutory provision in question. Rather, it refers to whether compliance has been achieved with "the essential requirements" of the statute (*Wentworth* v. *Medellin*, 529 S.W.2d 125, 128 (Tex. Civ. App. 1975)). State courts, which have considered the term in a variety of contexts, hold that "substantial compliance" refers to the role played by the provision that has been violated in the statutory scheme: if the provision is central to the objective of the statute, then violation negates "substantial compliance," while if the provision is merely peripheral and the statutory purpose has been achieved, then "substantial compliance" may occur despite the violation.[2] Accord, *Bonwit Teller & Co.*

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[2]See, *e.g.*, *City of Lenexa* v. *City of Olathe*, 660 P.2d 1368, 1373 (Kan. 1983) (citation omitted) (" 'Substantial compliance' • • • refers to 'compliance in respect to the essential matters necessary to assure every reasonable objective of the statute.' "); *In re Santore*, 623 P.2d 702, 707-708 (Wash. App. 1981) ("Substantial compliance has been defined as actual compliance in respect to the substance essential to every reasonable objective of the statute."); *Houman* v. *Mayor & Council*, 155 N.J. Super. 129, 169, 382 A.2d 413, 434 (Super. Ct. Law Div. 1977) (citation omitted) (" 'Substantial compliance' • • • occurs whenever • • • partial compliance has fully attained the objective of the statute."); *Smith* v. *State*, 364 So. 2d 1, 9 (Ala. Crim. App. 1978)

v. *United States*, 283 U.S. 258, 264-265 (1931); *Grannis* v. *Ordean*, 234 U.S. 385 (1914); *Mutual Life Ins. Co* v. *Phinney*, 178 U.S. 327, 337 (1900). "Substantial compliance" has nothing to do with the clarity or ambiguity of the statutory provision involved; indeed, it is common for the courts to hold that a violation is "merely technical," and "substantial compliance" has occurred, even though there has been a clear violation of an unambiguous statutory requirement (such as requirements relating to the form of notice).[3] There is no indication in the legislative history of the Secretary's withholding and cease-and-desist authority that Congress used the term in any way other than this accepted sense.

The prohibition in the Elementary and Secondary Education Act of 1965 against use of federal funds to supplant state and local expenditures is no mere "technical" matter. Indeed, it goes to the core of the congressional intent:

> The cornerstone of ESEA and similar Federal aid-to-education programs is the premise that Federal aid must supplement — not supplant — State and local

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(Substantial compliance means "compliance in respect to the substance essential to every reasonable objective of the statute [where] * * * the purpose of the statute is shown to have been served."); *Dorignac* v. *Louisiana State Racing Commission*, 436 So. 2d 667, 669 (La. Ct. App. 1983) (Substantial compliance occurs where "the statute has been followed sufficiently so as to carry out the intent for which it was adopted.").

[3]See, *e.g.*, *Houman* v. *Mayor & Council*, 155 N.J. Super. 129, 169, 382 A.2d 413, 434 (Super. Ct. Law Div. 1977) (public meeting was in substantial compliance with statutory requirements, despite clear violation of unambiguous requirements regarding the form of notice); *Wentworth* v. *Medellin*, 529 S.W.2d 125, 128 (Tex. Civ. App. 1975) (notice given prior to repossessing property was in substantial compliance with statutory requirements, despite clear violation of requirements regarding form); *Opinion of the Justices*, 275 A.2d 558, 562 (Del. 1971) (prior publication of proposed constitutional amendments was in substantial compliance with constitutional requirements, despite clear violation of requirements regarding timing).

> expenditures. The historic intent is that Federal dollars must represent an additional effort for the target children; thus, State and local education program expenditures must be maintained at previous levels.

H.R. Rep. 95-1137, 95th Cong., 2d Sess. 139 (1978). When the "supplanting" prohibition was originally adopted, the Senate Committee listed seven areas in which "local agencies have expended title I funds for purposes other than the education of educationally deprived children"; the first such area was "[t]he supplanting of State and local funds with title I funds." S. Rep. 91-634, 91st Cong., 2d Sess. 9 (1970). The Committee explained (*id.* at 10):

> The mission of title I involves overcoming the educational deprivations of children who are the victims of poverty. It is incumbent upon Federal, State, and local officials to assure that the funds are concentrated on the priority needs of poor children and are not diverted to meeting other needs of school systems, however pressing these other needs may be.

In short, the statutory prohibition against "supplanting" goes to the heart of the statutory purpose; it insures that federal funds are spent to enhance the educational opportunities of deprived children, rather than to meet other needs of school systems. See Pet. 12-13 nn.10, 11. The federal auditors found that the State's violation of this prohibition resulted in a use of federal funds to replace state and local funds that would otherwise have been spent on these children (C.A. App. 34-35). No reasonable concept of "substantial compliance" would excuse this type of violation.

3. Indeed, the court of appeals did not hold that respondent substantially complied with the Secretary's interpretation of the supplanting prohibition. The court instead held that "in the absence of unambiguous statutory

and regulatory requirements," the State need only comply "with a reasonable interpretation of the law" (Pet. App. 12a). Consequently, respondent's counterstatement of the question presented—limiting the issue to whether a "substantive standard of substantial compliance" should be used—misrepresents the true nature of the decision below. As stated in our petition, the crucial issue presented by the decision below more accurately is whether the right of federal agencies to recoup misspent grant funds is limited to cases in which no reasonable argument can be adduced to justify the expenditure.

For the foregoing reasons and those presented in the petition, it is respectfully submitted that the petition for a writ of certiorari should be granted.

REX E. LEE
Solicitor General

AUGUST 1984

DOJ-1984-08

JOINT

APPENDIX

No. 83-1798 (4)

In the Supreme Court of the United States

OCTOBER TERM, 1984

T.H. BELL, SECRETARY OF EDUCATION, PETITIONER

v.

COMMONWEALTH OF KENTUCKY,
DEPARTMENT OF EDUCATION

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE SIXTH CIRCUIT

JOINT APPENDIX

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PETITION FOR CERTIORARI FILED ON MAY 3, 1984
CERTIORARI GRANTED ON OCTOBER 1, 1984

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* The opinions of the Education Appeal Board, the Secretary of Education, and the court of appeals are printed in the appendices to the petition for writ of certiorari and have not been reproduced.

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 82-3319

COMMONWEALTH OF KENTUCKY,
DEPARTMENT OF EDUCATION

v.

SECRETARY OF EDUCATION,
UNITED STATES DEPARTMENT
OF EDUCATION

DOCKET ENTRIES

DATE		Filings—Proceedings
1982		
5/17	1)	Petition to Review an Order of the Secretary of Education and Education Appeal Board. (m-5/17/82) mdm
5/17		Certified Copy of Petition issued to respondent pursuant to Rule 15, FRAP. mdm
6/8	2)	Letter requesting Pre-Argument Statement by 6/18/82. mdm
6/14	3)	Appearance of S. Freid for respondent mdm
6/14	4)	Appearance of A. Rosenthal for respondent. mdm
6/14	5)	Disclosure of corporate affiliations and financial interest for respondent.
6/15	6)	Pre-Argument Statement filed on behalf of appellant. mdm
6/28	7)	Certified List from Dept. of Education. mdm

DATE		Filings—Proceedings
1982		
8/10		Brief (10) of petitioner (m-8/9) kmp
9/13		Brief (10 of respondent (m-9/9) kmp
9/30		Joint Appendix (5) (m-9/29) kmp
10/21	8)	Additional citations submitted by respondent (m-10/19) kmp
1983		(PAPERS FOR THE COURT)
5/17	9)	Motion: petitioner to postpone oral argument until sometime after Supreme Court disposition of Bell v. State of New Jersey (m-5/16) kmp
5/25	10)	Order denying petitioner's motion to postpone oral argument (Merritt, J.) gm
6/13		Cause argued by Chenoweth for petitioner, by Freid for respondent and case submitted to the Court (Before: Merritt, Kennedy and Weick, JJ.) gm
9/14	11)	Judgment of agency is reversed, each party to bear its own costs, (Merritt, Kennedy and Weick, JJ.) svh
9/14	12)	Opinion by Kennedy, J. svh
*6/6	13)	Additional citations submitted by respondent (m-6/) kmp
9/23	14)	Motion: respondent's petition for rehearing to 10/28/83 (m-9/22) (Extension Granted, per J. Kennedy, 9/26) kmp
10/28	15)	Petition for Rehearing; w/Suggestion of Rehearing En Banc submitted by respondent (m-10/27) kmp
12/5	16)	Order denying petition for rehearing en banc (Merritt, Kennedy and Weick, JJ.)

DATE		Filings—Proceedings
1983		
12/13	17)	Mandate issued (No costs taxed) gm
12/13		Opinion with mandate gm
1984		
5/10	18)	Notice of filing petition for certiorari (S. Ct. No. 83-1798) 5/3/84 gm

LIST OF THE AGENCY RECORD IN THE APPEAL OF THE STATE OF KENTUCKY

(Docket No. 1-(31)-77; Audit Control No. 04-70005)

1. Report on Review of Administration of the Elementary and Secondary Education Act of 1965—Title I Projects at Local Educational Agencies Administered by the Kentucky Department of Education for the Period July 1, 1967 through June 30, 1974 issued by the HEW Audit Agency (ACN: 04-70005) (October 29, 1976)
2. Final Determination Letter issued by Robert R. Wheeler, Deputy Commissioner for Elementary and Secondary Education (Deputy Commissioner) to James Graham, Kentucky Superintendent of Public Instruction (December 6, 1976)
3. Application for Review of final determination letter filed with the Chairman of the Title I Audit Hearing Board by the Kentucky Department of Education (Kentucky) (January 25, 1977)
4. Letter from David S. Pollen, Chairman of the Education Appeal Board (EAB), to James Graham, Kentucky Superintendent of Public Instruction, notifying Kentucky of the time and location of the prehearing conference (October 9, 1979)
5. Transcript of prehearing conference (November 8, 1979)
6. Letter from David S. Pollen, Chairman of the EAB to counsel transmitting the transcript of the November 8, 1979 prehearing conference (November 15, 1979)
7. Prehearing conference statement issued by EAB Panel setting forth the schedule for further proceedings (November 19, 1979)

8. Motion for summary judgment and memorandum in support of motion filed by counsel for Kentucky (December 19, 1979)
9. Motion for summary judgment filed by counsel for the Deputy Commissioner (December 21, 1979)
10. Kentucky's response to Deputy Commissioner's motion for summary judgment (January 19, 1980)
11. Response of Deputy Commissioner to Kentucky's motion for summary judgment (January 25, 1980)
12. EAB Panel's Order on Motions for Summary Judgment (May 7, 1980)
13. Letter to Panel Chairman from counsel for the Deputy Commissioner on acceptable dates for a status call (May 16, 1980)
14. Letter from Panel Chairman to counsel on scheduling a status call for June 13, 1980 (June 2, 1980)
15. Letter from Panel Chairman to counsel setting forth the schedule of further proceedings as agreed to at the status call (June 17, 1980)
16. Documentary evidence filed by Kentucky (Kentucky Exhibits 1-13) (August 1, 1980)
17. Letter from counsel for the Assistant Secretary for Elementary and Secondary Education (Assistant Secretary) to the Panel Chairman stating that the Assistant Secretary was not filing any rebuttal evidence (September 2, 1980)
18. Kentucky's Brief (October 14, 1980)
19. Stipulation setting forth facts agreed to by the parties (October 22, 1980)
20. Responsive Brief of the Assistant Secretary (November 14, 1980)
21. Kentucky's Reply Brief (December 5, 1980)

22. Motion for oral argument filed by Kentucky (December 18, 1980)
23. Letter to Panel Chairman from counsel for the Assistant Secretary responding to Kentucky's motion for oral argument (January 6, 1981)
24. EAB Panel's Order granting Kentucky's motion for oral argument (January 9, 1981)
25. Transcript of oral argument (January 30, 1981)
26. Letter from David S. Pollen to counsel transmitting the transcript of the January 30, 1981 oral argument (February 19, 1981)
27. Letter to the Chairman of the EAB from counsel for the Assistant Secretary attaching corrections to the transcript of the oral argument (March 5, 1981)
28. Initial Decision issued by the EAB Panel (June 23, 1981)
29. Letter from David S. Pollen to counsel transmitting the Panel's Initial Decision (June 25, 1981)
30. Comments on Initial Decision filed by counsel for Kentucky (July 9, 1981)
31. Comments on Initial Decision filed by counsel for the Assistant Secretary (July 30, 1981)
32. Responsive Comments on Initial Decision filed by counsel for the Assistant Secretary (July 24, 1981)
33. Responsive Comments on Initial Decision filed by counsel for Kentucky (July 27, 1981)
34. Decision of Secretary of Education remanding appeal to the EAB (August 27, 1981)
35. Letter from David S. Pollen to EAB Panel members on Secretary's decision to remand the appeal to the EAB (August 31, 1981)
36. EAB Panel's Order Inviting Supplemental Briefs (September 23, 1981)

37. Supplemental Brief of Kentucky (October 26, 1981)
38. Supplemental Brief of the Assistant Secretary (October 27, 1981)
39. Letter to Panel Chairman from counsel for the Assistant Secretary on Kentucky's Supplemental Brief (November 3, 1981)
40. EAB Panel's Order Affirming Initial Decision (January 5, 1982)
41. Letter from David S. Pollen to counsel transmitting the EAB Panel's Order Affirming Initial Decision (January 18, 1982)
42. Comments on the EAB's Panel Order Affirming Initial Decision filed by counsel for the Assistant Secretary (February 2, 1982)
43. Comments on the EAB Panel's Order Affirming Initial Decision filed by counsel for Kentucky (February 5, 1982)
44. Responsive comments on the EAB Panel's Order filed by counsel for the Assistant Secretary (February 16, 1982)
45. Responsive comments on the EAB Panel's Order filed by counsel for Kentucky (February 19, 1982)
46. Decision of the Secretary of Education modifying the EAB Panel's Initial Decision (March 19, 1982)
47. Letter to Raymond Barber, Kentucky Superintendent of Instruction, from David S. Pollen transmitting the Secretary's decision and stating that proceedings before the EAB are closed (March 22, 1982)
48. Letter to Raymond Barber, Kentucky Superintendent of Instruction, from David S. Pollen informing Kentucky that the Secretary's decision became final on May 18, 1982 (May 21, 1982)

[SEAL]

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE

REGION IV

30 Seventh Street, NE. Room 132
Atlanta, Georgia 30323
October 29, 1976

Audit Agency

Audit Control No. 04-70005

Dr. James B. Graham
Superintendent of Public Instruction
Department of Education
Commonwealth of Kentucky
Capitol Plaza Tower
Frankfort, Kentucky 40601

Dear Dr. Graham:

Enclosed for your information and use is a copy of an HEW Audit Agency report titled, "Review of Administration of the Elementary and Secondary Education Act of 1965 Title I Projects at Local Educational Agencies Administered by the Kentucky Department of Education for the Period July 1, 1967, Through June 30, 1974." Your attention is invited to the audit findings and recommendations contained in the report. The below named official will be communicating with you in the near future regarding implementation of these items.

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), HEW Audit Agency reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act, which the Department chooses to exercise. (See Section

5.71 of the Department's Public Information Regulation, dated August 1974, as revised.)

To facilitate identification, please refer to the above audit control number in all correspondence relating to this report.

Sincerely,

/s/ Emil A. Trefzger, Jr.
EMIL A. TREFZGER, JR.
Regional Audit Director
HEW Audit Agency—Region IV

Enclosure

HEW Action Official:

Deputy Commissioner, Bureau of School Systems
Office of Education, 400 Maryland Ave., S.W.
Washington, D.C. 20202

CONTENTS

REPORT ON REVIEW OF ADMINISTRATION OF THE ELEMENTARY AND SECONDARY EDUCATION ACT OF 1975 TITLE I, PROJECTS AT LOCAL EDUCATIONAL AGENCIES ADMINISTERED BY THE KENTUCKY DEPARTMENT OF EDUCATION FOR THE PERIOD JULY 1, 1967 THROUGH JUNE 30, 1974

INTRODUCTION

Background

Title I of the Elementary and Secondary Education Act (ESEA) of 1965 as amended, authorizes Federal financial support to Local Educational Agencies (LEAs) to meet the special educational needs of educationally deprived children residing in school attendance areas having high concentrations of children from low-income families. The amount of aid that an LEA is eligible to receive under a basic Title I grant is determined on a formula basis—the primary factor is the number of children from low-income families residing in the district. To participate in the program, State Educational Agencies (SEAs) must formally apply to the Office of Education (OE), U.S. Department of Health, Education, and Welfare (DHEW), and assure OE that the program will be administered in accordance with the provisions of the law and Federal regulations. Programs in Kentucky are administered by the Kentucky Department of Education, Division of Compensatory Education, the SEA. Funds totaling $32,212,788 were granted to the SEA for Title I programs at LEAs for fiscal year 1974.

Scope of Audit

The primary objective of this review was to determine whether the SEA's administration of the Title I program had resulted in the design and implementation of fiscal

year 1974 Title I projects to meet the special educational needs of educationally deprived children having the greatest need for assistance and residing in eligible attendance areas. Emphasis was focused on the LEA's policies and procedures for designating Title I target areas; LEAs' policies and procedures for selecting participants; LEAs' procedures regarding expenditures for readiness programs; and SEA's procedures to evaluate the educational achievements of LEA activities.

We also followed-up on the status of recommendations contained in our prior audit report covering fiscal year 1966 and 1967.

• • • •

Work Performed in the Area of Supplementary Expenditures for Readiness Programs

We surveyed the SEA's files to determine the LEAs which proposed readiness programs. We interviewed four readiness teachers and made a review of 229 questionnaires completed by readiness teachers at 66 LEAs.

• • • •

HIGHLIGHTS OF AUDIT RESULTS

Improvements are needed in the SEA's administration of the Title I program to assure that projects are designed and implemented to meet the most pressing needs of the educationally deprived children in eligible attendance areas. Our reviews of fiscal year 1974 projects showed that: (1) Title I expenditures were not concentrated on a limited number attendance areas, as required by Federal regulations; (2) reading, math, and preschool project components served a significant number of students who did not have the greatest educational need for assistance; and (3) expenditures were incurred by LEAs for readiness programs which did not supplement State and local expenditures for educationally deprived children. We estimate that $10.1 million was expended in

fiscal year 1974 for these purposes. Such expenditures impair the effectiveness of Title I activities by not concentrating services in the school attendance areas and on students as intended by the Act. Our review also showed that the data obtained by the SEA for the Statewide Title I evaluation report did not accurately reflect the educational achievements of the Title I activities.

The SEA can improve its designations of target areas; project application forms and written instructions for assessing educational needs and for selecting students to participate; monitoring of project activities; procedures to verify the data supporting evaluation reports on educational achievements on the Title I activities; and its interpretation of what constitutes supplanting. The SEA viewed supplanting as a reduction in the number of State and local teachers employed in the project area, while we interpret supplanting to be a decrease in the State and local support for the educationally deprived children participating in Title I activities.

In the written response to our draft report, the SEA did not comment on the finding and recommendations on the need to improve evaluation procedures. On the remaining findings, the SEA generally did not take issue with the factual content of the findings, but disagreed with our application of Federal criteria, our conclusions and our recommendations.

These findings are discussed in more detail in the Results of Audit section and the complete response of the SEA is included as Appendix A to this report. To facilitate a complete understanding of the findings, the SEA's position, and propriety of our recommendations, we have included the Audit Agency's comments with the SEA's response in Appendix A.

• • • •

RESULTS OF AUDIT

During fiscal year 1974, Title I project expenditures of about $10.1 million were not concentrated, as required

by the regulations, in a limited number of attendance areas, for those students having the greatest need for assistance, or in a manner that supplemented the expenditure of State and local funds for educationally deprived children. Consequently, we believe the effectiveness of the Title I program has been impaired. The SEA can improve the program's operation by: requiring that LEA's select target schools in accordance with methods prescribed in the Title I regulations; revising application forms and issuing written instructions for assessing educational needs and selecting students for participation; improving and expanding monitoring activities; implementing procedures to verify the data supporting evaluation reports on educational achievements on Title I activities; and by altering its interpretation of the supplanting provision in the regulations. The SEA views supplanting as a reduction in non-Title I teachers employed in the project area. We interpret supplanting as a decrease in State and local support for the educationally deprived children participating in Title I activities and a corresponding increase in support for that activity under Title I.

These findings are discussed in more detail under the captions: Need to Improve Policies and Procedures for Designating Target Areas; Need to Improve Policies and Procedures for Selecting Title I Participants; Need to Assure that Readiness Expenditures Are Supplementary; and Need for Improved Evaluation Procedures.

• • • •

Need to Assure that Readiness Expenditures Are Supplementary

During fiscal year 1974, about $1.65 million was budgeted to be expended for services to students enrolled in self-contained Title I readiness classes. Based on an average budgeted per pupil expenditure, approximately $704,237 (including $79,377 at ineligible school attend-

ance areas) was incurred for educational services provided to 1,109 Title I students who as a result of the Title I program did not receive appropriate State and local support. (See Exhibit D for details.) In our opinion, Section 116.17(h) of the regulations provides that each educationally deprived child is entitled to a fair share of expenditures from State and local funds. Consequently, Title I expenditures, in order to be supplementary, have to be in addition to those expenditures the child would have normally received from State and local funds. The SEA officials interpreted the regulations differently and, as a result, approved the use of Title I funds by LEAs to defray substantially all the cost for educating students in readiness classes. Section 116.17 (h) of the regulations provides:

> "Each application for a grant under Title I of the Act for educationally deprived children residing in a project area shall contain an assurance that the use of the grant funds will not result in a decrease in the use for educationally deprived children residing in that project area of State or local funds which, in the absence of funds under Title I of the Act, would be made available for that project area and that neither the project area nor the educationally deprived children residing therein will otherwise be penalized in the application of State and local funds because of such a use of funds under Title I of the Act. No project under Title I of the Act will be deemed to have been designed to meet the special educational needs of educationally deprived children unless the Federal funds made available for that project (1) will be used to supplement, and to the extent practical increase, the level of State and local funds that would, in the absence of such Federal funds, be made available for the education of pupils participating in that project; (2) will not be used to supplant State and local funds available for the education of such pupils; and (3) will not

be used to provide instructional or auxilliary services in project area schools that are ordinarily provided with State and local funds to children in non-project area schools."

We interpret the above regulations to mean that the advent of Title I funds shall not result in a decrease in the use of State and local support for the education of the educationally deprived children residing in the project area. The SEA officials viewed supplanting as the failure of an LEA to employ the number of non-Title I teachers that State and local funds were made available for, by school and grade, based on average daily attendance (ADA) statistics. The SEA's view does not relate to the per pupil expenditure and does not give the Title I student his fair share of services purchased with State and local funds. Further, the concept of a readiness program is to primarily prepare a child for the first grade. However, the SEA's view permits the use of the readiness class to serve as a general educational first grade.

During fiscal year 1974, about 69 LEAs proposed Title I projects with readiness components. According to the SEA, readiness programs are designed to provide students with the experiences and background they needed to start learning. Further, these programs were similar to preschool programs, except readiness was concentrated on school age children. Information obtained from 233 Title I readiness teachers showed that 85 percent of the readiness programs were implemented in self-contained classrooms and were concentrated primarily on children enrolled in the first grade. In this regard, readiness teachers generally taught a class of approximately 13 students all day long. The information obtained also showed that LEAs provided readiness services in self-contained classrooms to 2,604 students including 2,311 first graders and 293 students in grades two and above. Further, of the 233 readiness teachers, 145 expected to promote 1,109 students to the next higher grade during

the coming 1974-75 school year, which indicates their receipt of school credit for readiness instruction.

When educationally deprived children receive readiness instruction in a self-contained classroom in which Title I pays for substantially all of the instructional and supportive service cost, then the supplementary nature of Title I is questionable, even considering that some students will be retained and, consequently, will receive their share of State and local support in the subsequent year. However, when students receive first or second grade credit for readiness instruction and are passed to the next higher grade, then the program in our opinion serves as a regular first or second grade class. During the 1974-75 school year, 1,109 readiness students were expected to be promoted to the next grade. The cost of the readiness services was budgeted from Title I funds; therefore, readiness students did not receive their fair share of State and local support while they were in these grades. As a result, the LEAs' budget expenditure of about $704,237 (including $79,377 at ineligible school attendance areas) during fiscal year 1974 supplanted the use of State and local funds. By law, such expenditures cannot be deemed to have met the needs of the educationally deprived children.

Recommendations

We recommend that the SEA:

1. Refund to OE funds used during fiscal year 1974 for readiness classes at the 50 LEAs identified in Exhibit D. The estimated amount to be refunded is $704,237.
2. Amend its State policies and procedures to include a statement that the implementation of readiness programs through Title I funds cannot deprive the educationally deprived children in such programs from their fair share of State and local support.
3. Disapprove project applications in the future which indicate that LEAs plan to implement readiness

components in a manner contrary to recommendation No. 2 (above).

State Agency Response

The SEA did not agree that the Federal criteria on supplanting and supplementing should be applied on an individual child basis. Excerpts from the SEA's response are:

> "The basic issue is whether the Federal criteria on supplanting versus supplementing is to be applied on a per pupil (individual student) basis or on a school, or grade level, or classroom basis.
>
> "It has been the SEA's understanding that the supplementary provision was not necessarily carried to the point of the individual student. Rather we believe that Section 116.17(h) supported our position. Section 116.17(h) uses the term 'children' consistently and repeats it several times in the paragraph. This is collective identification as to a group, class, grade level, or school. . . .
>
> "In specific project components, like readiness programs, the SEA requires the LEA to continue to staff the total number of teachers which the total number of students in each grade level within a school would warrant by ADA through the state Minimum Foundation Program. . . .
>
> "It is acknowledged that the U.S. Office of Education's interpretation on the supplementary issue may be changing subsequent to inclusion of the 'excess cost' provision in P.L. 93-380. If the U.S. Office of Education solidifies its position and develops a definition of supplanting versus supplementing which is contrary to the position now held by the SEA, the SEA will adjust its position accordingly."
>
> "If the position stated in the report reflecting *per pupil expenditure* were carried throughout Title I

> project operations, there could be no Title I programs conducted during the regular or legal school day as all children would be compelled to remain in regular (state supported) classrooms. Further, if this extreme application were made in most rural Kentucky school districts where the majority of the children are transported to and from school by bus and are only at the school for the minimum legal length school day, eligible children could not be served by Title I projects. We believe this interpretation would be extreme and would not be in keeping with the intention of the Act."

Auditor's Comments

The regulations state ". . . the use of grant funds will not result in a decrease in the use for educationally deprived children residing in that project area of State or local funds . . ." Children residing in a project area make up the readiness program and were provided first and second grade general education as evidenced by their promotions to the next higher grade.

We do not intend to imply that our position would be applied to the extreme and require all ESEA Title I programs to be conducted outside of regular school hours. Nor would we accept the other extreme of providing first and second grade general education under the ESEA Title I program.

In our opinion, the readiness programs should have been in addition to the general education at the grade level or designed to prepare the student for that grade.

• • • •

EXHIBIT D

Estimate of Readiness Expenditures Incurred by LEAs For Fiscal Year 1974 Which Were Not Supplementary

LEA	Estimated Expenditures	Readiness Expenditures Included in Cost Recommended for Adjustment Under Target Area Designation	Net Amount Estimated
McCracken County	$ 3,810	$ —	$ 3,810
Cardwell County	7,620	—	7,620
Carroll County	9,525	—	9,525
Caverna County	6,985	—	6,985
McLean County	6,985	—	6,985
Somerset Independent	3,175	—	3,175
Butler County	6,985	2,540	4,445
McCreary County	1,270	1,270	—
Casey County	13,971	—	13,971
Breckinridge County	635	—	635
Fulton Independent	5,715	2,540	3,175
Owen County	9,525	—	9,525
Logan County	19,686	—	19,686
Clay County	56,517	9,525	46,992
Lynch Independent	7,620	—	7,620
Campbellsville Independent	11,430	—	11,430
Cumberland County	19,051	—	19,051
Hickman County	4,445	4,445	—
Walton-Verona Independent	3,810	—	3,810
Hopkins County	13,336	—	13,336
Monroe County	5,080	635	4,445
Newport Independent	1,270	—	1,270
Fulton County	2,540	—	2,540
Madison County	36,196	—	36,196
Mayfield Independent	6,985	—	6,985
Metcalfe County	2,540	—	2,540
Ice County	19,050	—	19,050
Jefferson County	6,986	—	6,986

LEA	Estimated Expenditures	Readiness Expenditures Included in Cost Recommended for Adjustment Under Target Area Designation	Estimated Net Amount
Bourbon County	16,511	—	16,511
Wayne County	4,445	—	4,445
Paris Independent	17,146	—	17,146
Meade County	11,430	—	11,430
Elliot County	635	—	635
Barren County	43,816	—	43,816
Earlington Independent	5,080	—	5,080
Danville Independent	15,241	—	15,241
Paducah Independent	48,897	—	48,897
Leslie County	9,525	3,175	6,350
Bath County	17,146	—	17,146
Knox County	22,226	—	22,226
Ohio County	31,751	11,431	20,320
Christian County	4,445	—	4,445
Laurel County	38,736	6,350	32,386
Whitley County	31,751	26,671	5,080
Barbourville Independent	10,796	—	10,796
Martin County	19,686	—	19,686
Graves County	27,940	—	27,940
Ballard County	5,715	—	5,715
Robertson County	7,620	—	7,620
Russell County	20,956	10,795	10,161
Total	$704,237	$79,377	$624,860

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE
OFFICE OF EDUCATION
Washington, D.C. 20202

Dec. 6, 1976

Our Reference: ACN: 70005-04

Honorable James B. Graham
Superintendent of Public Instruction
State Department of Education
Frankfort, Kentucky 40601

Dear Superintendent Graham:

Reference is made to the HEW Audit Agency report of audit of the administration of the Title I, ESEA, program by the Kentucky Department of Education for the period July 1, 1967 through June 30, 1974.

In accordance with the procedure for Title I, ESEA, audit settlement set forth in an October 23, 1974, memorandum from the U.S. Commissioner of Education to Chief State School Officers, this final determination letter sustains the recommendations set forth in the referenced final report dated October 29, 1976. This action is taken after reviewing the draft of the auditors' report, as well as your agency's response of April 30, 1975, plus the accompanying documentation that is incorporated in the final report. We also took into consideration the information we obtained at the exit conference held in Frankfort, Kentucky, on January 20, 1975.

Our final determinations are that it will be necessary for your agency to undertake measures that will implement the recommendations made by the auditors with respect to program deficiencies, and that the State agency refund $704,237 to the U.S. Office of Education. This amount represents the unallowable expenditures incurred for the readiness classes during Fiscal Year 1976.

If your agency concurs with our final determinations, you should submit payment in the amount of $704,237 to the U.S. Office of Education. Should your agency wish to appeal our final decision, you may request a hearing. The procedures for a hearing on appeal of final audit determinations is contained in Enclosure No. 1 of this letter.

If we do not hear from you within thirty (30) days from the date of this letter, we will refer this matter to our Finance Division for collection and/or adjustments.

Sincerely,

(Sgd.) Robert R. Wheeler

ROBERT R. WHEELER
Deputy Commissioner for
Elementary and Secondary Education

cc: Title I Coordinator
Regional Commissioner
Regional Program Specialist

Enclosure

COMMONWEALTH OF KENTUCKY
DEPARTMENT OF EDUCATION
Frankfort, Ky. 40601

James B. Graham
Superintendent of Public Instruction

January 25, 1977

Honorable David S. Pollen
Chairman, Audit Hearing Board
Department of Health, Education, and Welfare
Office of Education
Washington, D.C. 20202

Subject: Application for review of the final determination letter of the audit of the Title I, ESEA, program by the Kentucky Department of Education for the period July 1, 1967 through June 30, 1974.

Reference: Docket No. 1-(31)-77
ACN: 70005-04

Dear Chairman Pollen:

The Department of Education of the Commonwealth of Kentucky, hereby makes application for review of the final determination letter of the audit of the Title I, ESEA, program by the Kentucky Department of Education for the period July 1, 1967, through June 30, 1974, and requests a hearing thereon. (Copy of final determination letter and the extension letter are attached hereto.)

In support thereof the Department of Education of the Commonwealth of Kentucky (hereinafter referred to as SEA) states that the following questions (set forth in Roman Numerals) are to be resolved and the SEA's positions and reasons for its positions (identified by letters) are respectfully submitted as follows.

I

Whether or not the expenditure of Title I funds in certain school districts in Kentucky for the period in question were a "supplement" to the expenditure of state and local funds and are therefore proper or whether expenditures supplanted state and local effort and were therefore improper.

A. From the beginning of the readiness program in 1969, SEA has openly and consistently taken the position that in determining whether or not a proposed program is constituted "supplemented" as opposed to "supplanting", calculations and decisions should be based on a grade level or classroom level rather than on a per pupil level.

B. The 1974 HEW Audit Agency took the position that such determination should be calculated on a per pupil basis.

C. The SEA's interpretation is reasonable and proper and is supported by regulation 116.17(h). Throughout the entire regulation and in Section 116.17(h) in particular, the references are consistently and without exception to the collective plural term "children". At no time is the individual or singular term "child" used.

If the HEW Audit Agency's position reflecting *per pupil expenditure* were applied throughout Title I project operations, there could be no Title I programs conducted during regular school hours as all children would be compelled to remain in regular (state supported) classrooms. Further, if this extreme application were made in most rural Kentucky school districts where the majority of the children are transported to and from school by bus and are only at the school for the minimum legal length school day, eligible children could not be served by Title I projects. We believe HEW Audit Agency's inter-

pretation is extreme and not in keeping with the Legislative intent.

D. Not only is the SEA's interpretation reasonable, proper and supported by the regulation, but its interpretation of the application was tacitly approved by management review teams of the Office of Education who annually reviewed selected local school districts in Kentucky including school districts in which the type of readiness programs were then in progress. Such teams did not question or take any exception to such programs prior to the time that exceptions were taken to such programs by the HEW Audit Agency in 1974.

E. It is submitted that if the determination is to be made on a grade level basis rather than a per pupil basis that SEA can conclusively show that the readiness programs now questioned were indeed a supplement to the local and state effort and not a supplanting of such effort and were, therefore, proper.

II

Whether or not the $704,237 that HEW Audit Agency claims should be refunded is so arbitrary, capricious and speculative in nature that it can be the basis of a required refund.

A. The audit report is silent as to how the $704,237 in question was determined. From a conference with the local auditors and their superiors, it is the understanding of the SEA that the following procedures were used to make the determination.

(1.) Questionnaires were presented directly to superintendents in sixty-nine school districts where readiness programs were being conducted with Title I SEA funds during 1974.

(2.) The superintendent was instructed to have each of his teachers who were in Title I readiness programs to answer the questionnaire and they were returned to the audit agency.

(3.) The key questions contained in the questionnaire were:

(i) Is the program self-contained?

(ii) If the decision were made today, how many of these children would be promoted to the next grade level?

(4.) If the question as to self-containment was answered in the negative, no exception was taken to the program.

(5.) In all school districts where the answer as to self-containment was in the affirmative, exception was taken.

Of the sixty-nine LEA's polled, fifty school districts answered the questionnaire in the affirmative and, therefore, exception was taken to all fifty.

(6.) Of these fifty districts, sixteen were in target area designation classifications which the agency was questioning on other grounds not pertinent to this hearing.

(7.) In those sixteen districts the LEA's applications for that year were considered. From these applications the estimated salaries and estimated cost of the readiness program in the aggregate for the sixteen districts was determined. This included estimated teachers' salaries and estimated cost of supplies.

(8.) In addition the estimated cost of supportive services was calculated for each of the sixteen districts.

(9.) The estimated number of pupils in the readiness program was requested on the ques-

tionnaire and that estimate as to the number of pupils in the program was compared to the estimated total number of pupils in Title I programs for each of the sixteen districts. A ratio of estimated readiness pupils to estimated total Title I pupils was determined. From that ratio an average estimated supportive services cost per pupil was determined for those sixteen districts.

(10.) By adding the average estimated cost of the program per pupil to the estimated cost of supportive services per pupil, a figure of $635.02 was arrived at by the Audit Agency as being the total estimated cost per pupil.

(11.) Taking the teachers' estimate as to the number of students who would likely be retained at the same grade level and substracting that from previous years' estimated number of pupils participating in the readiness program, the Audit Agency arrived at the estimated number of readiness pupils likely to pass to a higher grade level.

(12.) The Audit Agency then multiplied the estimated number of pupils likely to pass in each of the fifty school districts by $635.02 (the estimated total cost per pupil in each of the sixteen districts) to arrive at a total requested refund of $704,237.

B. It is submitted that this estimate, upon estimate is so speculative as to be arbitrary and capricious and cannot be the basis of a required refund.

The readiness teachers salaries and supply expenses were based on 1973 estimates. Supportive services, supplies estimates and other costs were based on 1973 estimates. The number of students in the readiness programs and other Title I programs

were based on 1973 estimates. Nineteen hundred seventy-three (1973) was the year of impoundment of funds and school administrators concern about such impoundment of funds might well have caused them to estimate at higher costs than they would normally do because of that concern. The number of students likely to be retained was what teachers estimated in April of the school year. Thirty-four of the fifty school districts in question are having cost estimates based upon estimates of other school districts applied to them without any consideration of their own estimates, much less their actual cost.

The supportive services should not be subjected to the refund. For example the school districts estimated that they would have three hundred (300) Title I students, fifty (50) of which would be in readiness programs and on that basis employed a nurse and guidance counselor for the three hundred (300) students. The employment of the guidance counselor and the nurse would have been justified by the other Title I students even if no credit was to be given for the readiness program.

C. The scheme used by the Audit Agency to arrive at the refund figure, points up the untenableness of the Audit Agency position.

It seeks to exact a penalty only in those situations where the readiness program was highly successful. It is only in those situations where, because of the more favorable pupil-teacher ratio and having teachers and programs oriented and concentrated toward their educationally deprived needs, the children were determined to be ready to participate in the regular classes that the Audit Agency would now exact a penalty. This certainly is not the intent of Congress nor of the Office of Education.

In conclusion it is submitted that in determining whether there has been a supplementing or supplanting

of local and state effort, the program should be evaluated on a grade level basis. That under such evaluation the readiness programs in the school districts in question should be deemed to be supplemented by the state and local effort, and, therefore, a proper expenditure of Title I funds. That the HEW Audit Agency's claimed required refund is so speculative as to be arbitrary and capricious and cannot be the proper basis for requiring a refund.

Respectfully submitted,

/s/ James B. Graham
JAMES B. GRAHAM
Superintendent of
Public Instruction

/s/ Edward L. Fossett
EDWARD L. FOSSETT
Attorney,
Department of Education
Commonwealth of Kentucky

EDUCATION APPEAL BOARD

U.S. DEPARTMENT OF EDUCATION

Docket No. 1-(31)-77

Audit Control No. 04-70005

APPEAL OF THE STATE OF KENTUCKY

STIPULATION

The parties in this appeal hereby stipulate that:

1. The Department of Health, Education, and Welfare Audit Agency (HEWAA) auditors reviewed 187 Fiscal Year 1974 Title I project applications from local educational agencies (LEAs) in Kentucky to identify the LEAs that proposed readiness programs.

2. On April 19, 1974, the HEWAA sent the letter and questionnaires attached as Tab A to the LEAs that had proposed readiness programs in their Title I project applications. Each Title I readiness teacher was requested to complete a questionnaire. The HEWAA auditors received a total of 229 completed questionnaires from Title I readiness teachers in 65 LEAs. In one additional LEA, Russell County, four readiness teachers were interviewed by the HEWAA auditors in lieu of having them complete the questionnaire.

3. Based on the responses to the questionnaires and the interviews in the one LEA, the auditors concluded that the Title I readiness programs were self-contained (with the exception that art, music, physical education,

and library services were provided by state and locally funded teachers to the same extent that such programs were provided for non-readiness program students) in the 50 LEAs listed in Exhibit D of the October 29, 1976 HEWAA Audit Report.

4. Attached as Tab B is Part II of the Fiscal Year 1974 Title I project application for the Russell County LEA which describes the readiness program. A similar description was contained in the Title I project applications of the other 49 LEAs that had self-contained readiness programs in Fiscal Year 1974.

5. The HEWAA auditors determined that $704,237 of Title I funds was misspent for the readiness programs in the 50 LEAs. The auditors calculated that $704,237 had been misspent by multiplying $635.02 (the estimated per pupil expenditure for the Title I readiness program) by 1109 (the number of children participating in the readiness programs in the 50 LEAs who were expected to be promoted to the next grade level in the following year).

6. The estimated per pupil expenditure of $635.02 was computed by taking the total Fiscal Year 1974 budget for the readiness component ($634,896.87) and a prorated share of the supportive services component ($62,353.29) in 16 sampled LEAs, and dividing the total ($697,250.16) by the estimated number of participants in the readiness programs in the 16 LEAs (1098). The prorated share for supportive services in each of the 16 LEAs was calculated by applying a per pupil cost for supportive services times the estimated number of Title I participants in the readiness programs.

7. The total number of children participating in the readiness programs in the 50 LEAs who were expected to be promoted to the next grade level in the following school year was determined by the auditors to be 1109. The 1109 figure was based on the responses of the readiness teachers to the questionnaires sent to each LEA. According to these responses by the Title I readiness

teachers, 865 first grade children and 244 second grade children were expected to be promoted to the next grade level in the following year. The total number of participants in the Title I readiness programs in the 50 LEAs, according to the responses to the questionnaires, was 2604.

/s/ Stephen Freid
STEPHEN FREID

/s/ Arnold Rosenthal
ARNOLD ROSENTHAL

Attorneys for the
Assistant Secretary
for Elementary and
Secondary Education

/s/ Edward L. Fossett
EDWARD L. FOSSETT

Attorney for the Kentucky
Department of Education

SUPREME COURT OF THE UNITED STATES

No. 83-1798

TERREL H. BELL, SECRETARY OF EDUCATION, UNITED STATES DEPARTMENT OF EDUCATION, PETITIONER

v.

KENTUCKY DEPARTMENT OF EDUCATION

ORDER ALLOWING CERTIORARI

Filed October 1, 1984

The petition herein for a writ of certiorari to the *United States Court of Appeals for the Sixth Circuit* is granted.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1984 484278 11008

AMICUS CURIAE

BRIEF

Nos. 83-1798 and 83-2064

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

SECRETARY OF EDUCATION,
UNITED STATES DEPARTMENT OF EDUCATION,
Petitioner,

v.

COMMONWEALTH OF KENTUCKY
DEPARTMENT OF EDUCATION

T.H. BELL, SECRETARY OF EDUCATION,
Petitioner,

v.

STATE OF NEW JERSEY

On Certiorari to the United States Courts of Appeals for the Third Circuit and for the Sixth Circuit

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BRIEF FOR THE LAWYERS' COMMITTEE FOR CIVIL RIGHTS UNDER LAW AS *AMICUS CURIAE* IN SUPPORT OF REVERSAL

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On Certiorari to the United States Courts of Appeals for the Third Circuit and for the Sixth Circuit

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BRIEF FOR THE LAWYERS' COMMITTEE FOR CIVIL RIGHTS UNDER LAW AS *AMICUS CURIAE*

INTEREST OF *AMICUS CURIAE*[1]

The Lawyers' Committee for Civil Rights Under Law was organized in 1963 at the request of the President of the United States to involve private attorneys in the national effort to assure civil rights for all Americans. The Committee has, over the past 21 years, enlisted the

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[1] Letters from counsel for the parties consenting to the filing of this brief have been submitted to the Clerk.

services of over a thousand members of the private bar in addressing the legal problems of minorities and the poor.

The Lawyers' Committee has had a long-standing interest in Title I of the Elementary and Secondary Education Act of 1965[2] because of the statutory emphasis upon meeting the needs of poor and disadvantaged children. The Committee has sought to promote vigorous enforcement of the programmatic and fiscal restrictions in the statute and implementing regulations.[3]

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[2] In 1981 the Title I program was replaced by "Chapter 1" of the Education Consolidation and Improvement Act of 1981, Pub. L. No. 97-35, §§ 552 *et seq.*, 95 Stat. 464-69 (codified at 20 U.S.C. §§ 3801 *et seq.* (1982)). Chapter 1 retains the Title I focus upon assisting educationally disadvantaged children residing in high poverty areas, *see* Pub. L. No. 97-35, § 552, 95 Stat. 464 (codified at 20 U.S.C. § 3801 (1982)), as well as the specific targeting and non-supplanting provisions of the Title I law, *see id.*, §§ 556(b)(1), 558(b), 95 Stat. 466, 468 (codified at 20 U.S.C. § 3805(b)(1), 3807(b) (1982)). Hence, the rulings below have continuing importance for the major federal program of aid to elementary and secondary schools.

[3] In the early 1970's the Committee began to monitor the administration of the Title I program, in order to determine whether states and local school districts were using their grants to operate projects which carried out its basic purpose. These activities greatly intensified in 1975 with the establishment of the Committee's Federal Education Project. One of the Project's major goals was to stimulate adherence to the categorical restrictions of the Title I statute and regulations in order to increase the effectiveness of local compensatory programs. The Project served as an informational resource for parents of Title I participants and Title I staff in local school districts, and it provided legal representation to parents of Title I students in litigation and administrative complaint proceedings, including an important supplanting case, *Alexander v. Califano*, 432 F. Supp. 1182 (N.D. Cal. 1977).

In 1976, pursuant to a contract with the National Institute of Education, the Lawyers' Committee established a separately staffed unit, the Legal Standards Project, to investigate and analyze the legal framework of Title I. At the request of members of the Congressional authorizing committees, this project subsequently made extensive recommendations for legislative changes and prepared a draft bill. Many of its suggestions were incorporated in the Education Amendments of 1978, Pub. L. No. 95-561, 92 Stat. 2143, *reprinted in* 1978 U.S. Code Cong. & Ad. News 2143 *et seq.*, and the Congress' reliance upon the work of the Legal Standards Project is acknowledged in the legislative history of the 1978 amendments.

Appropriations for Title I and Chapter 1 were not and are not unlimited. For this reason, each year thousands of educationally deprived students cannot receive compensatory services. Congress was conscious of this fiscal reality and wrote into law a set of requirements that are central to the functioning of an effective program, including (1) accurate targeting of compensatory projects to serve only eligible schools and attendance areas, and (2) continuation of state and local expenditures for basic education programs for participating children so that federally funded projects provide *extra* services to needy students.

Compliance with these requirements is essential, in our judgment, to the educational effectiveness of compensatory instruction projects funded by the federal government. Our experience indicates that meaningful compliance depends, in significant part, upon the expectation that audit and recoupment of misspent funds will follow any failure to adhere to the terms and conditions of the program. Thus, the Committee is concerned that the holdings below anouncing rules of construction which defeat recovery of funds not expended in accordance with grant-in-aid agreements accepted by Kentucky and New Jersey, will have a detrimental impact upon educational opportunities for poor children by weakening the incentive for adherence to statutory and regulatory requirements.

Rather than crediting ingenious arguments that evade the Congressional intention expressed in these statutory restrictions, as the courts below did, state and local education officials should be held to adhere to the fiscal and program limitations of federal law, as interpreted by the Department of Education, when audit proceedings are subjected to judicial review.

STATEMENT

In 1965, Congress enacted Title I of the Elementary and Secondary Education Act,[4] which provided federal grants to states and local school districts for programs designed to assist educationally deprived children in areas with high concentrations of low-income families. In order to ensure that Title I grants benefited these children, the statute included specific conditions with which state education agencies (SEAs) and local education agencies (LEAs) were required to comply.[5] Two conditions are particularly relevant to these cases: *first*, Title I funds could be expended only for projects serving eligible attendance areas and schools; *second*, students participating in Title I projects had to receive their "fair share" of state and local expenditures so that federal funds provided truly supplemental services.[6] State and federal audits were authorized to assess local compliance with statutory criteria.

New Jersey and Kentucky participated in the Title I program each year following its enactment and were aware of the various statutory and regulatory requirements for participation. However, audits conducted by the United States Department of Health, Education and Welfare[7] resulted in determinations that both States had misapplied substantial amounts of federal Title I funds.

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[4] Pub. L. No. 89-10, 79 Stat. 27, *reprinted in* 1965 U.S. Code Cong. & Ad. News 29, as renumbered by Pub. L. No. 89-750, § 116, 80 Stat. 1191, 1198, *reprinted in* 1966 U.S. Code Cong. & Ad. News 1392, 1400.

[5] These conditions were repeated and amplified in the administrative regulations and further clarified in numerous Title I Program Guides sent to all of the states as early as 1968. *See infra* notes 48-51 & accompanying text, 55-57 & accompanying text.

[6] The same sorts of restrictions apply to the grant-in-aid program which replaced Title I. *See supra* note 2.

[7] The Title I program was administered by the Department of Health, Education and Welfare prior to the creation of the Department of Education by Pub. L. No. 96-88, 93 Stat. 668, *reprinted in* 1979 U.S. Code Cong. & Ad. News 668 (codified at 20 U.S.C. §§ 3401 *et seq.* (1982)).

New Jersey. Federal auditors found that the SEA incorrectly approved Title I grant applications for the 1970-71 and 1971-72 school years from the Newark LEA, which then used the grant funds in school attendance areas that were not eligible to participate in the Title I program.[8] New Jersey disputed these findings,[9] but except for reductions required by a "statute of limitations"[10] the Education Appeal Board sustained the auditors' claims and the Secretary of Education declined

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[8] *See* Joint Appendix at 11-34, *Bell v. New Jersey*, —— U.S. ——, 76 L. Ed. 2d 312 (1983) (Final Audit Report) [hereinafter cited as N.J.J.A.]. The federal statute required that projects be located to serve "school attendance areas having high concentrations of children from low-income families," 20 U.S.C. § 241e(a)(1)(A) (1970). Regulations and Title I Program Guides issued between 1965 and 1970 by the Department of Health, Education and Welfare, *see Wheeler v. Barrera*, 417 U.S. 402, 407, 420 n.14 (1974), defined this term to mean attendance areas having higher-than-average numbers or percentages of children from poor families than the school district as a whole. *See generally* N.J.J.A. at 14-16; *infra* pp. 23-27.

[9] The dispute as to the 1970-71 school year is whether the Newark LEA qualified for an exception to the usual eligibility requirement, *see supra* note 8, because there was "no wide variance," within the meaning of the regulations and Program Guides, in the level of poverty among the district's school attendance areas. The dispute as to the 1971-72 school year concerns the correct manner of documenting and comparing levels of poverty among attendance areas in determining eligibility.

[10] 20 U.S.C. § 884 (Supp. IV 1974), as added by Pub. L. No. 93-380, § 106, 88 Stat. 484, 512, *reprinted in* 1974 U.S. Code Cong. & Ad. News 541, 576, provided that:

> No state or local educational agency shall be liable to refund any payment made to such agency under this Act (including Title I of this Act) which was subsequently determined to be unauthorized by law, if such payment was made more than five years before such agency received final written notice that such payment was unauthorized.

See also H.R. Rep. No. 805, 93rd Cong., 2d Sess. 78-79, *reprinted in* 1974 U.S. Code Cong. & Ad. News 4093, 4160. The currently applicable version of this provision is codified at 20 U.S.C. § 1234a(g) (1982).

to disturb its decision.[11] On review of the Department's action in the Court of Appeals,[12] a panel held that 1978 amendments to Title I which eased the eligibility requirements for school attendance areas [13] should be given retrospective effect so as to validate the earlier expenditures to the extent that they would have been proper under the new eligibility criteria.[14] The panel remanded to the Secretary of Education to determine precisely which of the challenged expenditures would have been permissible under the 1978 statutory amendments.[15]

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[11] *See* N.J. Pet. at 13a-15a.

[12] *See id.* at 15a n.12.

[13] Pub. L. No. 95-561, § 101(a), 92 Stat. 2143, 2161-62 (codified at 20 U.S.C. § 2732(a)(1) (1982)).

[14] N.J. Pet. at 4a-5a.

[15] There are two reasons why the expenditures in question might not have been lawful even had they been made after 1978. *First*, as the court below recognized, use of the provision added in 1978 was conditioned upon a special "maintenance of effort" requirement for compensatory programs; since New Jersey had not sought to rely upon the 1978 law prior to review in the Court of Appeals, the record previously made in the administrative proceedings is not adequate to determine whether this condition has been met (*see* N.J. Pet. at 5a). *Second*, the Title I law and regulations always required that projects be of "sufficient size, scope and quality" to offer hope of significant achievement gains for participants. *See* Pub. L. No. 89-10, § 2, 79 Stat. 27, 30, *reprinted in* 1965 U.S. Code Cong. & Ad. News 29, 33 (current version at 20 U.S.C. § 2734(d) (1982)). This requirement usually resulted in a school district's establishing Title I projects at fewer than all eligible schools, in light of limited Congressional appropriations—which never reached the authorization level contained in the statute. *See infra* note 51. Because, in this case, the federal auditors determined that the number of eligible schools was itself improperly inflated, they had no occasion to consider whether Newark's Title I program during the years in question otherwise met the "size, scope and quality" requirement. Thus, even if the 1978 amendments' 25%-eligibility provision could be used in Newark, questions about the program's conformity with other statutory and regulatory requirements would remain. Nevertheless, this matter is ripe for review since the decision below finally—and erroneously—determines the issue of retroactivity and will bind the Department of Education in Title I audit cases which are now pending and which may in the future arise from the States within the Third Circuit. *Cf.* N.J. Pet. at 16 ($68 million in Title I audit claims pending).

Kentucky. In Fiscal Year 1974, with SEA approval, some 50 LEAs throughout the state placed first- and second-grade Title I participants in separate classrooms with Title I teachers. Except for a few "enrichment classes," these students received their entire academic instruction, including the basic state-mandated curriculum, through the federally funded Title I program.[16] Although gross state and local expenditures at Title I schools were not reduced, again with the exception of the enrichment classes the students participating in Title I did not receive the benefit of any of these expenditures.

Federal auditors concluded that these practices constituted "supplanting" in violation of the statutory requirement that Title I funds

> be [so] used (i) as to supplement . . . the level of funds that would, in the absence of such Federal funds, be made available from non-Federal sources *for the education of pupils participating in programs and projects assisted under this subchapter*, and (ii) in no case, as to supplant such funds from non-Federal sources.[17]

With certain modifications not relevant to the issues before this Court, the Education Appeal Board and the Secretary of Education upheld the auditors' supplanting findings.[18] A panel of the Court of Appeals, however,

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[16] Ky. Pet. at 22a (findings of Education Appeal Board).

[17] 20 U.S.C. § 241e(a)(3)(B) (1970) (emphasis added).

[18] The Audit Report sought repayment only of those Title I funds expended on readiness classes for students who were promoted to the next grade level at the end of the school year—apparently to avoid any question whether students retained at the same grade level would ultimately receive their "fair share" of state and local

refused to sustain the repayment demand. While the Department's interpretation of the statutory anti-supplanting language and implementing regulations was "reasonable" and would be controlling in future cases, the Court of Appeals said:

> [T]he statutory and regulatory provisions at issue were [not] sufficiently clear to apprise the Commonwealth of its responsibilities. . . .
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> . . . .
>
> [I]t is unfair for the Secretary to assess a penalty against the Commonwealth for its purported failure to comply substantially with the requirements of law, where there is no evidence of bad faith and the Commonwealth's program complies with a reasonable interpretation of the law.[19]

SUMMARY OF ARGUMENT

I

Because the 1978 amendments to Title I explicitly were not made effective prior to October 1, 1978; because the statutory change upon which New Jersey seeks to rely is a substantive, rather than procedural or remedial one; because this matter arises from the state's voluntary acceptance of pre-1978 statutory terms and conditions under a federal grant program; and because the rule of retroactivity adopted by the Third Circuit is unworkable in

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resources when they repeated the same curriculum. *See* Joint Appendix in No. 83-1798, at 17 (Final Audit Report). The Department of Education adopted this position, despite the misgivings of the Education Appeal Board (*see* Ky. Pet. at 30a), and the case does not now turn upon the propriety of this approach. *See* Ky. Pet. at 16a. Additionally, the Secretary reduced the demand for repayment in light of the fact that the "readiness" classes were smaller than most regular classes in the state (*see* Ky. Pet. at 38a-42a). The correctness of this adjustment is also irrelevant at this time: the Sixth Circuit's ruling eliminates *any* repayment of *any* funds on account of *any* supplanting.

[19] Ky. Pet. at 9a-10a, 12a.

both the legislative and administrative process, its judgment should be reversed.

II

Because the case before the Sixth Circuit originated in Kentucky's petition for judicial review of agency action, once the Court of Appeals concluded that the Education Department's interpretation of the Title I statute and regulations was a "reasonable" one, it should have deferred to the agency. In addition, the view of the panel below that the statute and regulations were ambiguous is unsupportable.

III

Contrary to the arguments of New Jersey and Kentucky and the intimations of the courts below, the grant conditions which the auditors found those states to have violated were adopted early in the history of the Title I program, were repeatedly communicated to the states, and were critical to the effectiveness of the compensatory projects funded by the federal government.

ARGUMENT

Introduction

In *Bell v. New Jersey*, —— U.S. ——, ——, 76 L. Ed. 2d 312, 326 (1983), this Court ruled "that the pre-1978 version of [Title I] requires that recipients be held liable for funds that they misuse"[20] by making repay-

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[20] *See also id.*, 76 L. Ed. 2d at 322, quoting S. Rep. No. 634, 91st Cong., 2d Sess. 84, *reprinted in* 1970 U.S. Code Cong. & Ad. News 2768, 2827 ("Even though there may be difficulties arising from recovery of improperly used funds, those exceptions must be enforced if the Congress is to carry out its responsibility to the taxpayer"). The states are, of course, accorded substantial opportunities to demonstrate the propriety of challenged expenditures and have a right to judicial review prior to making any repayment. *See id.*, 76 L. Ed. 2d at 327-28.

ment to the United States.[21] The decisions below will substantially frustrate the ability of the federal government to obtain such repayments. Without any basis in the statutory language or legislative history, and contrary to longstanding administrative interpretations of the law, the courts below extinguished the obligations of Kentucky and New Jersey to repay Title I funds expended in contravention of statutory and regulatory provisions[22] in force at the time the states accepted Title I

[21] Up to 75% of the amount recovered may be returned to the state to be used, "to the extent possible, for the benefit of the population that was affected by the failure to comply or by the misexpenditures which resulted in the audit exception," 20 U.S.C. § 1234e(a)(2) (1982). *See* Ky. Pet. at 15 n.13.

[22] For purposes of resolving the legal issues presented to this Court, it must be assumed that the states and their constituent LEAs failed to comply with relevant federal program requirements. *See Bell v. New Jersey*, 76 L. Ed. 2d at 327.

In the *Kentucky* case, the Sixth Circuit panel declined to enforce the Secretary's demand for repayment because of its view that the Title I regulations were "ambiguous," the misexpenditures identified by the auditors therefore did not constitute "substantial noncompliance," and for this reason repayment of the misspent funds was an "unfair . . . penalty" (*id.* at 12a). But the Court of Appeals agreed that the expenditures for "readiness" classes were inconsistent with the Department of Education's "reasonable" interpretation of the Title I statute and regulations (Ky. Pet. 8a-9a) and the Commonwealth has not challenged that determination.

In the *New Jersey* case, the state has acknowledged that " 'there were irregularities in the original grant approval process' " (N.J. Pet. 46a) resulting from the presence of a "flaw in the initial formula" used to determine eligible school attendance areas in the Newark district (*id.* at 45a). *See id.* at 40a (Decision of Education Appeal Board) ("the New Jersey SEA admits it did not meet the Title I requirements for determining the eligibility of school attendance areas for Title I funding when it approved Newark's 1971-72 project application with respect to 13 Newark schools"). Although New Jersey argued that at least some of these schools would have been eligible under a proper formula (*see id.* at 8a), the Third Circuit never decided this question. In 1981 that court held that the Secretary of Education had no authority to order repayment of misexpended funds, *New Jersey v. Hufstedler*, 662

grants.[23]

We agree fully with the United States that the rulings below are doctrinally unsound, for the reasons outlined in the first two arguments below. In addition, we submit that these rulings may ultimately be traced to the lower courts' erroneous perception that states and local school districts were burdened by unfair or unclear programmatic and fiscal restrictions which interfered with the educational efficacy of Title I projects. However, as we show in the third argument, the conditions which New Jersey and Kentucky violated were very deliberately inserted into the statutory scheme by Congress; they are central to the success of the compensatory education effort; they are comprehensible and capable of straightforward application; and they were promulgated and clearly explained to state officials by the federal government prior to the misexpenditures which are the subject of these suits.

I

The Third Circuit's Retroactivity Holding Is Contrary to Established Legal Principles And Is Unworkable

In the *New Jersey* case, the Third Circuit erroneously applied well-settled rules of statutory construction when it held that eligibility criteria enacted in 1978 could be

F.2d 208, *rev'd sub nom. Bell v. New Jersey*, —— U.S. ——, 76 L. Ed. 2d 312 (1983). On remand, the Third Circuit applied 1978 statutory amendments retroactively to validate Newark's eligibility determinations which, it said, "arguably overstated the relative size of the class of students from low-income families" (N.J. Pet. at 3a). The only question now before this Court, therefore, is whether the 1978 amendments should have been applied in this retrospective manner to excuse New Jersey from the obligation it would otherwise have to repay funds to the Department of Education.

[23] *See* 76 L. Ed. 2d at 326 ("The State chose to participate in the Title I program and, as a condition of receiving the grant, freely gave its assurances that it would abide by the conditions of Title I").

applied retrospectively, so as to excuse a Title I grant recipient's noncompliance with different criteria that were contained in federal law when the disputed expenditures were made (in 1970-71 and 1971-72). The 1978 amendments to Title I specifically provided that "the provisions of this Act and the amendments and repeals made by this Act [24] shall take effect October 1, 1978.[25] Thus, the panel below erred in concluding that "[t]here is . . . nothing in the 1978 amendments or the legislative history [which] indicates that the amendments were not intended to be applied retroactively" (N.J. Pet. 4a). And, that being the case, the predicate for application of the *Bradley*[26] principle evaporates.

Moreover, *Bradley* involved remedial, not substantive, changes in the law;[27] thus, even in the absence of the legislative directive for prospective application contained in the 1978 amendments,[28] *Bradley* would be inapplicable. Where new legislation alters a substantive provision of

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[24] New Jersey does not contend, and the Third Circuit did not hold, that the 1978 amendments explicitly repealed or explicitly amended, retrospectively, the previous eligibility standards which the auditors found to have been violated. Repeals by implication of course are not favored. *E.g., Kremer v. Chemical Construction Company*, 456 U.S. 461, 468-78 (1982).

[25] Pub. L. No. 95-561, § 1530, 92 Stat. 2143, 2380, *reprinted in* 1978 U.S. Code Cong. & Ad. News 2143, 2380.

[26] *Bradley v. School Board of Richmond*, 416 U.S. 696 (1974). *See* N.J. Pet. 4a.

[27] In *Bradley*, this Court noted that upon enactment of § 718 of the Education Amendments of 1972, authorizing the award of attorneys' fees to prevailing plaintiffs in school desegregation cases, "there was no change in the substantive obligation of the parties." 416 U.S. at 721. Here there is no question about the substantive impact of the 1978 amendments in altering school attendance area eligibility criteria. *See also Bell v. New Jersey*, 76 L. Ed. 2d at 318 n.3.

[28] *See supra* note 25 and accompanying text.

a statutory scheme, the general rule is that it is to be given prospective effect only.[29]

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[29] *E.g., United States v. Security Industrial Bank*, 459 U.S. 70, 79 (1982). *Compare* N.J. Pet. at 17a-18a (summarizing New Jersey's earlier arguments against retroactive application of 1978 amendment to Title I delineating audit repayment obligation).

Congress uses explicit language when it wishes a substantive statutory amendment to have retrospective effect. For example, in 1984 the House of Representatives adopted amendments to the Gneral Education Provisions Act designed to alter the auditing and repayment process. *See* 129 Cong. Rec. H7891 (introduction of final version), H7902-03 (§ 808), H7904 (passage) (daily ed., July 26, 1984). These amendments deliberately avoided the use of language which would have given them retrospective application in pending audit proceedings. As their primary floor sponsor recognized, retroactivity

> would violate the basic principle that grantees should be held accountable for the expenditures of funds under the law as it was when they received the funds. A current law standard would treat differently grantees who received funds at the same time. Depending on when they were audited, grantees would be held to different program requirements based upon the state of the law when they were audited. A grant might be made on the basis of one set of standards, an audit conducted on a second, an administrative appeal heard on a third, and judicial review sought on a fourth.

Id. at H7814 (Rep. Ford) (daily ed., July 25, 1984).

However, the measure adopted by the House would have made certain provisions of the *1978 Title I amendments* retrospective. Section 808(a)(4) of Rep. Ford's floor amendment, *id.* at H7903 (daily ed., July 26, 1984), provided:

> In any final audit determination pending before the Secretary of Education or the Education Appeals Board on or made after the date of enactment of this Act pursuant to section 452 of the General Education Provisions Act (20 U.S.C. 1234b), the provisions of sections 122(a)(1) and 132 of the Elementary and Secondary Education Act of 1965 (20 U.S.C. 2732(a)(1), 2752) shall be considered to apply with respect to expenditures made before October 1, 1978, in the same manner that such provisions apply to expenditures made on or after that date, without regard to the provisions of subsections (b)(2),

There is a further reason why the *Bradley* principle is inapplicable to the dispute between New Jersey and the United States. Because it arises out of the state's voluntary acceptance of federal funds in exchange for "its assurance that it would abide by the conditions [contained in the statute and regulations]," [80] the case is governed by principles of contract law. Post-grant legislation is relevant only insofar as it unambiguously represents a waiver of the contractual conditions.[81] Absent such a waiver, there is no basis for modifying the con-

(e), and (f) of section 131 of such Act (20 U.S.C. 2751) requiring that certain determinations be made in advance.

This portion of the bill would have mooted the *New Jersey* case by authorizing retrospective use of the "25% rule." It was, however, dropped from the legislation prior to its final passage. *See* 129 Cong. Rec. S12906 (Sen. Hatch), S12908 (Sen. Kennedy) ("One issue that was included in the House legislation but dropped in conference was the audit reform provisions"), S12909 (passage of conference report) (daily ed., October 3, 1984); *id.* at H11425 (Rep. Hawkins), *id.* (Rep. Jeffords), H11426 (Rep. Ford), H11429 (Rep. Goodling), H11430 (acceptance of conference report) (daily ed., October 4, 1984).

This history indicates that the Congress can and does employ explicit retroactivity language when it desires to create an exception to the general rule that substantive amendments apply only prospectively, especially in grant programs.

[80] *Bell v. New Jersey*, 76 L. Ed. 2d at 326-27; *see also, id.* at 329 (White, J., concurring).

[81] Enactment of a bill directing the Secretary of Education not to seek to recover misexpenditures identified in audits completed prior to a specified date would constitute a waiver. (Such measures were considered by the Congress in 1980 and 1981 but never enacted. *See Dismissing Certain Cases Pending Before the Education Appeal Board: Hearings on H.R. 8145 Before the Subcommittee on Elementary, Secondary and Vocational Education of the House Comm. on Educ. & Labor*, 96th Cong., 2d Sess. (1980) (bill never reported out); 127 Cong. Rec. S5427-30, S5442 (daily ed., May 21, 1981) (floor amendment rejected on point of order).) Similarly, the five-year "statute of limitations" on repayment of misexpenditures of Title I funds, *see supra* note 10, is such a waiver under the circumstances specified in that provision.

tractual understanding between the parties by virtue of a subsequent enactment applying to future grants; this amounts to rewriting the contract to the detriment of the Department of Education, and that of the program's beneficiaries.

Finally, because of its consequences both for the legislative process and for administration of federal assistance programs, the Third Circuit's ruling is unworkable. As this Court is well aware, the statutory framework of federal grant programs rarely remains completely unchanged; rather, successive Congresses often amend and re-amend an enactment in the light of experience and perceptions. Indeed, State and local grantees are among the most fervent supporters of this "fine tuning." [82] For this reason, if the decision below is permitted to stand, federal grantees subject to audit exceptions can be expected to seek repeated statutory changes that would make their past non-compliance with program requirements conform to the law. The incentive to maintain compliance with statutory and regulatory provisions will

[82] *See, e.g., Oversight Hearing on Amendments to Title I of ESEA and GEPA: Hearings Before the Subcommittee on Elementary, Secondary and Vocational Education of the House Comm. on Educ. & Labor*, 96th Cong., 1st Sess. 26-32 (1979) (testimony of New York City Schools Chancellor Macchiarola supporting amendment to drop matching funds requirement for schoolwide projects); *Education Amendments of 1977: Hearings on S. 1753 Before the Subcommittee on Education, Arts and Humanities of the Senate Comm. on Human Resources*, 95th Cong., 1st Sess. 1554-58 (1977) (statement of Akron Superintendent of Schools Conrad Ott, requesting amendment to permit continuing services to students who formerly attended Title I-eligible schools that were closed); *id.* at 1397-99 (statement of Pennsylvania Secretary of Education Caryl M. Kline, proposing modification of supplanting provision); *Elementary and Secondary Education Amendments of 1973: Hearings on H.R. 16, H.R. 69, H.R. 5163, and H.R. 5823 Before the General Subcommittee on Education of the House Comm. on Educ. & Labor*, 93rd Cong., 1st Sess. 419 (1973) (testimony of Chicago Assistant Superintendent James Moffat, seeking elimination of annual school eligibility requirement).

be substantially diminished; federal program beneficiaries—in this case, educationally disadvantaged children who most need assistance—will be the losers.

The Third Circuit's approach imputes to the Congress, each time a grant program statute is amended, an intention to have the new provision apply in all pending administrative or judicial proceedings that relate to prior grants. Adoption of this standard, so different from that which presently prevails,[83] will vastly complicate the legislative process. Deliberations about the public policy benefits of any particular amendment will have to be accompanied by the production and analysis of large quantities of information about the current status of all audit exceptions or claims under the grant program, in order to assess the impact of retrospective application of the amendment in such proceedings. It simply defies experience to expect that the Congress will be able to shoulder these additional burdens and engage in reasoned lawmaking.

Since audit or claim proceedings often take years to resolve, many will be repeatedly affected by statutory changes under the Third Circuit's ruling, largely depriving the administrative enforcement process of the finality which is necessary if grantees are to know what is expected of them. Moreover, while the result is to New Jersey's liking in this instance, there seems to be no compelling reason why statutory changes which tighten, rather than relax, program requirements should not also be given retrospective application according to the rule adopted below. For it is inherently no more unjust to recover grant funds from states which fail to anticipate changes in the law than it is to deprive participants in federally funded grant programs of substantial additional benefits[84] because of such changes.

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[83] *See supra* note 29 and accompanying text.

[84] *See supra* note 21.

It is far more realistic, and sensible, to give substantive statutory changes retroactive effect only when Congress explicitly indicates its intention that this result should obtain.[85] That has long been the preferred approach; because the Third Circuit panel departed from that approach without justification, its judgment cannot stand.

II

The Sixth Circuit Erred by Refusing to Follow the Department of Education's "Reasonable" Interpretation of the Statute and Regulations and by Inventing a Wholly Inappropriate Standard for Repayment of Misspent Grant Monies

The Kentucky case reached the Sixth Circuit as a result of the state's petition for review of final administrative action taken by the Department of Education.[86] Accordingly, the task of the court below was a limited one: to determine "whether the [factual] findings of the Secretary are supported by substantial evidence and reflect application of the proper legal standards. § 455, 20 U.S.C. § 1234d(c); 5 U.S.C. § 706." *Bell v. New Jersey*, 76 L. Ed 2d at 328.

There was no controversy over the facts. The use of substantial amounts of Title I grant funds for "readiness" classes which substituted for participating students' regular, state and locally funded, academic education is admitted. The only matter for determination by the reviewing court was whether the reading of the statutory anti-supplanting language which is embodied in Departmental regulations, Program Guides, and the Secretary's interpretations thereof, was proper. As this Court has often emphasized, in this situation

> the task for the Court of Appeals was not to interpret the statute as it thought best but rather the

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[85] *See supra* note 29.

[86] *See Bell v. New Jersey*, 76 L. Ed. 2d at 318-20 n.3.

> narrower inquiry into whether the [agency's] construction was "sufficiently reasonable" to be accepted by a reviewing court. *Train* v. *Natural Resources Defense Council*, 421 U.S. 60, 75 (1975); *Zenith Radio Corp.* v. *United States*, 437 U.S. 443, 450 (1978). To satisfy this standard it is not necessary for a court to find that the agency's construction was the only reasonable one or even the reading the court would have reached if the question initially had arisen in a judicial proceeding. *Zenith Radio Corp.* v. *United States*, 437 U.S. 443, 450 (1978); *Udall* v. *Tallman*, 380 U.S. 1, 16 (1965); *Unemployment Compensation Commission* v. *Aragon*, 329 U.S. 143, 153 (1946).[37]

The Sixth Circuit panel concluded that the Secretary's interpretation of the supplanting prohibition was "reasonable," Ky. Pet. at 8a & n.6. Indeed, far from finding that interpretation to be contrary to law, the Sixth Circuit agreed that, at least prospectively, it would be controlling. *Id.* at 12a. Pursuant to the precedent cited above, that should have been the end of the matter. Instead, the panel below embarked upon a wholly different inquiry than that directed by this Court:

> Nonetheless, in the instant case we do not feel it is our task on appeal to review the reasonableness of the Secretary's interpretation of Title I section 241 e(a)(3)(B) and regulation section 116.17(h). We are not reviewing with reference to the future effect of the Secretary's interpretation of a statute. Rather, in this appeal we are concerned with the fairness of imposing sanctions upon the Commonwealth of Kentucky for its "failure to substantially

[37] *Federal Election Commission v. Democratic Senatorial Campaign Committee*, 454 U.S. 27, 39 (1981); *accord, e.g., Chevron, U.S.A. v. Natural Resources Defense Council*, 52 U.S.L.W. 4845, 4847 n.11 (U.S. June 25, 1984); *Indiana Department of Public Instruction v. Bell*, 728 F.2d 938, 940 (7th Cir. 1984); *Psychiatric Institute of Washington, D.C. v. Schweiker*, 669 F.2d 812, 813-14 (D.C. Cir. 1981) (*per curiam*); *West Virginia v. Secretary of Edu-*

> comply"[8] with the requirements of section 241e (a)(3)(B) and 45 C.F.R. 116.17(h), as those requirements were ultimately interpreted by the Secretary.

[8] *See* 20 U.S.C. § 1234b(a) and § 1234c(a) (1978) (where the Commissioner is said to act upon the belief that a recipient of funds had "failed to comply substantially" with any requirement of law applicable to such funds).

Id. at 9a (footnote omitted).

There simply is no basis in law for this approach. Nothing in the Title I statute suggests that there should be one standard of deference to the administrative agency's interpretation in a declaratory judgment action looking to the future and another in a judicial review proceeding following an audit and demand for repayment.[38] "[T]he pre-1978 version [of Title I] contemplated that States misusing federal funds would incur a debt to the Federal Government for the amount misused . . . ." *Bell v. New Jersey*, 76 L. Ed 2d at 321. If the law were as stated by the court below, then federal grantees could with impunity ignore the "reasonable" interpretations of statutory and regulatory language by administrative agencies until those interpretations were first confirmed in court. This would largely defeat the purpose of delegating interpretive rulemaking authority to the agencies in the first place. The fact that the Court of Appeals viewed the statute and regulations as ambiguous, *see* Ky. Pet. at 9a-10a, 12a, 15a, does not justify the Sixth Circuit's lack of deference to the agency's reading of the law, for it is Congress' in-

[38] 20 U.S.C. §§ 1234b(a) and 1234c(a), cited in footnote 8 of the Court of Appeals' opinion, are inapposite since they deal only with cease-and-desist orders and withholding proceedings, rather than audits. The difference in standard, which in any event would not lead to a difference of result in the *Kentucky* case, *see infra* pp. 27-29, is a rational one. *See* Ky. Pet. at 11 n.9.

tention that the administrative agency should make the choice among alternative interpretations. *See, e.g., Psychiatric Institute of Washington, D.C. v. Schweiker*, *supra* note 37.

Even on its own terms, the decision below is not defensible. Although the Sixth Circuit characterized Kentucky's position as a "reasonable" one, it supported this assertion only with very general statements from the legislative history of Title I. *See* Ky. Pet. at 11a-12a. The panel simply slid over the precision of the statutory language requiring that federal funds not supplant "funds that would, in the absence of such Federal funds, be made available from non-Federal sources for the education *of pupils participating in programs* and projects assisted" by Title I, 20 U.S.C. § 241e(a)(3)(B) (1970) (emphasis added). *See* Ky. Pet. at 20a. It also ignored Congress' separate insertion into the Title I law in 1970 of a "comparability" requirement, 20 U.S.C. § 241e(a)(3)(C) (1970), which is addressed specifically to equivalence of school-level expenditures, rather than to participant entitlements.[39]

The Sixth Circuit similarly gave little attention to the Title I supplanting regulation in force at the time of the expenditures in question, which was equally explicit about the need to provide Title I participants with their fair share of state and local expenditures:

> Each application for a grant under Title I of the Act for educationally deprived children residing in a project area should contain an assurance that the use of the grant funds will not result in a decrease in the use for educationally deprived children residing in that project area of State or local funds

[39] *See* S. Rep. No. 634, 91st Cong., 2d Sess. 14-15, *reprinted in* 1970 U.S. Code Cong. & Ad. News 2768, 2781-82; 116 Cong. Rec. 10613 (Rep. Quie) (daily ed., April 17, 1970).

> which, in the absence of funds under Title I of the Act, would be made available for that project area and that *neither the project area nor the educationally deprived children residing therein* [*i.e.*, Title I participants] *will otherwise be penalized in the application of State and local funds because of such a use of funds* under Title I of the Act.

45 C.F.R. § 116.17(h) (1973) (emphasis added). The real problem which the Court of Appeals had with the Kentucky audit exception apparently was not the supposed ambiguity of the statute or regulations, but the panel's lack of sympathy with the policy choice made by Congress:

> Given a fixed number of dollars awarded to the school district, the requirement that average per pupil expenditures be transferred to the Title I classrooms, in proportion to the number of students in attendance there who are expected to advance a grade, cannot help but have an adverse impact on the funds available for the regular classroom when the number of regular classrooms and teachers cannot be reduced.[40]

Ky. Pet. at 15a. As we pointed out at the beginning of this section, however, the task of a Court of Appeals engaged in judicial review of agency action does not extend to rewriting the statute to conform to the court's view of the wisest policy. *Compare Alexander v. Califano*, 432 F. Supp. 1182, 1189, 1190 (N.D. Cal. 1977).[41]

[40] In fact, the Secretary of Education had already taken the concern expressed by the panel into account in reducing the amount of repayment which he requested to reflect the smaller pupil-teacher ratios in Title I classes as compared to regular classes. *See supra* note 18.

[41] "One may well differ, as a matter of educational policy, with the legislative choice to concentrate rather than spread aid among educationally deprived children, but that is not a matter for this Court. . . . That the enforcement of the federal requirement is likely to have an impact on State and local programs and may require changes in State regulations and guidelines is not a ground for

The panel of the Court of Appeals in the *Kentucky* case erred in seeking to do this, and its judgment should be reversed.

III

The Eligibility and Supplanting Restrictions at Issue in These Cases are Directly Related and Critical to the Purposes of the Title I Program—and the States Had Both Ample Notice of their Applicability and Adequate Explanation of their Requirements

Throughout the course of these proceedings, both New Jersey and Kentucky have attempted to convey the impression that the eligibility and supplanting restrictions involved in these audits interfered with the realization of the goals of the Title I program in their states' school districts, and also that the Department of Education's interpretations of the statutory and regulatory language were never clearly articulated and explained until the audits had taken place. These arguments are, to some extent, echoed in the opinions of the courts below [42] and they may have contributed to the legal errors made by the Third and Sixth Circuits. In fact, the substantive requirements at issue in these cases—the determination of school and attendance area eligibility, and the prohibition against supplanting state and local resources—are of central importance to the integrity and effectiveness of federal compensatory education programs, which constitute the largest part of federal aid to elementary and secondary education. These requirements have been a

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disregarding that requirement. Nor is the wisdom of the policy to concentrate compensatory education funds on a small number of pupils a matter for the Court's consideration." (footnote omitted.)

[42] *See, e.g.*, N.J. Pet. at 4a ("Congress enacted these [1978] amendments to correct the *injustice* which the earlier eligibility standards worked in areas with high concentrations of low-income families) (emphasis supplied); Ky. Pet. at 9a ("we are concerned with . . . the requirements of section 241e(a)(3)(B) and 45 C.F.R. 116.17(h), as those requirements were *ultimately* interpreted by the Secretary") (emphasis supplied); *supra* p. 21, text at note 40.

part of the Title I and Chapter 1 programs since their inception in 1965; the states were clearly notified of their applicability and scope long before the expenditures questioned in these audits and should not have had any difficulty in complying with them.

Eligibility. As we have noted, in order to promote the statutory goals, expenditures of grant funds must be targeted on discrete populations ("educationally deprived children"). While it would be highly desirable to assist all students in need of services, limited appropriations for the Title I program made this impossible. Hence, the statute provided that appropriations were to be allocated among States and school districts according to the number of children from low-income families,[43] and that funds were granted only for programs which would contribute to meeting the needs of educationally deprived children in areas within school districts where there are large concentrations of children from such families.[44]

The project area eligibility standards are linked to the additional requirement, which was maintained throughout all versions of the statute since Title I was first passed in 1965, that programs must be "of sufficient size, scope and quality to give reasonable promise of substantial progress toward meeting" those special

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[43] *See* 20 U.S.C. § 241c(2) (Supp. IV 1968); 20 U.S.C. § 2711(c) (1982); *see also* 20 U.S.C. § 3803 (1982) [Chapter 1].

[44] *See* 20 U.S.C. § 241e(a)(1)(A) (Supp. IV 1968); 20 U.S.C. § 2782 (1982); *see also* 20 U.S.C. § 3805(b)(1)(A) (1982) [Chapter 1]; *Alexander v. Califano*, 437 F. Supp. at 1189 (referring to "the legislative choice to concentrate rather than spread aid among educationally deprived children"). Once eligible project areas are selected, every child determined to be educationally deprived, regardless of economic status, is eligible to receive services. Educational deprivation is the sole criterion for deciding which children in a project area will participate in these federal programs.

needs.[46] The purpose of this provision is to avoid dissipation of federal grants by spreading them among too many underfunded projects in too many different schools. Because local school administrators are almost always under intense pressure to serve as many students as possible,[46] the threshold determination of eligible school attendance areas facilitates compliance with the "size, scope and quality" requirement. It is, for this reason, critical to the operation of successful compensatory programs.

The importance of the eligibility standard was consistently emphasized by the federal government and was well known to the Congress. For example, in 1966 the House Committee on Education and Labor reported amendments to the statute and commented:

> The committee notes that during the first year of operation funds have primarily been used in special projects in schools with the highest concentrations of children from low-income families. This is to be encouraged especially since funds are limited and therefore must be concentrated on the most pressing needs.[47]

Initial regulations which had allowed areas that did not meet the "highest concentrations of children from low-income families" requirement to be included in Title I

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[46] Pub. L. No. 89-10, § 205(a)(1)(B), 79 Stat. 27, 30, *reprinted* in 1965 U.S. Code Cong. & Ad. News 29, 33 (codified at 20 U.S.C. § 241e(a)(1)(B) (Supp. IV 1968)); *see* 20 U.S.C. § 1805(b)(3) (1982) [Chapter 1].

[46] *See* N.J.J.A. at 176 (New Jersey Department of Education's Application for Review of Final Audit Determination) ("LEA had no choice but to assume high concentrations of low-income families in all attendance areas and to attempt to spread the benefits of Title I as broadly as possible to assure that most educationally deprived children would be served").

[47] H.R. Rep. No. 1814, 89th Cong., 2d Sess. 3, *reprinted* in 1966 U.S. Code Cong. & Ad. News 3844, 3846.

programs[48] were quickly amended in 1967 to remove this option,[49] and the change was specifically brought to the attention of state education officials.[50] Thereafter, communications from the federal level repeatedly directed attention to the eligibility criteria and explained in considerable detail how comparisons of poverty concentrations should be made.[51]

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[48] 45 C.F.R. § 116.17(b) (1966) provided that attendance areas with numbers or percentages of children from low-income families which were at least as high as the district-wide average were eligible to be designated as project areas, and that "[o]ther areas with high concentrations of children from low-income families may be approved as project areas but only if the State agency determines that projects to meet the most pressing needs of educationally deprived children in areas of higher than average concentration have been approved and adequately funded."

[49] The language quoted in the preceding footnote was removed by 32 Fed. Reg. 2742, 2744 (February 9, 1967) and never reappeared. *See* 45 C.F.R. § 116.17(d) (1968).

[50] Title I Program Guide No. 28, *see Wheeler v. Barrera*, *supra* note 8, issued on February 27, 1967 to Chief State School Officers and State Title I Coordinators by U.S. Commissioner of Education Harold Howe, II, advised (p. 2) that:

> 1. The revised Title I regulations differ from the previous regulations in two important respects regarding project areas:
>
> a. It is no longer permissible to designate as project areas attendance areas with less than average concentrations of children from low-income families.
>
> . . . .
>
> 2. The purpose of the "attendance area" requirement in Title I is to identify the "target population" from which the children with special needs are to be selected.

[51] For example, Title I Program Guide No. 44, issued March 18, 1968 by Commissioner Howe to Chief State School Officers and state Title I coordinators, collected in one document the "Revised Criteria for the Approval of Title I, ESEA Applications from Local Educational Agencies." Section 1 of that document elaborated upon the Title I regulations with practical instructions about how

. . . .

Thus, far from creating a situation of injustice, the eligibility restrictions were designed to insure that the

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to collect data and make the necessary attendance area comparisons to determine eligibility.

On November 20, 1968, Commissioner Howe distributed Program Guide No. 48, entitled "Improving the Quality of Local Title I Compensatory Education Programs." In that directive, the Commissioner emphasized the need to make wise use of the limited funds available for effective compensatory programs:

> Many Title I programs are based on the selection of individual children from many grade levels from *all* of the *attendance areas* which are technically eligible to be included in the Title I program. This approach has usually resulted in programs which are not as effective as they might be. . . .
>
> The purpose of this memorandum is to suggest an approach to the planning of Title I programs which can result in improved program quality. This approach includes the following major steps:
>
> 1. Focus resources on a number of children in the "target population"—those in the most impoverished school attendance areas;

Id. at 1, 2 (emphasis in original). Finally, in the Title I Program Guide No. 45A, issued July 31, 1969 by Associate Commissioner Leon Lessinger, Chief State School Officers and Title I Coordinators were advised:

> Your title I, ESEA, offices are now in the process of reviewing and approving applications for grants from the fiscal 1970 appropriation (advance funding). A number of State educational agencies have already made special efforts to insure high quality programs that meet all legal requirements. Information reaching this office concerning the administration of Title I indicates, however, that in some cases further efforts are likely to be required if charges of noncompliance with Federal program requirements are to be avoided.
>
> . . . .
>
> In reviewing Title I proposals the SEA should be particularly alert to the following indications of violations of basic Title I requirements:
>
> . . . .
>
> 1. The applicant proposes to provide Title I services to children who do not reside in areas determined to be eligible for Title I, ESEA, services.

. . . . [Continued]

expenditure of Title I funds actually provided some benefits to the students who participated in the compensatory programs, rather than being just "a drop in the bucket"—and the importance of these criteria was repeatedly brought to the notice of state education officials.[52]

Supplanting. Although the Title I statute, in its original 1965 formulation, contained no explicit "anti-supplanting" language, it did limit the use of grant funds to projects designed to meet the "special educational needs of educationally deprived children,"[53] which the Congress understood to incorporate the notion that Title I expenditures should supplement local programs.[54] Accordingly, from the outset the Title I regulations included a prohibition against supplanting.[55] By 1968, six years before the Kentucky expenditures at

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[51] [Continued]

> Each SEA should adopt a plan and schedule visits for monitoring local Title I programs. In checking on local program operations the SEA should take appropriate action if there is any evidence indicating violations, such as the following:
>
> 1. Use of Title I funds in areas not designated as eligible Title I areas.

[52] It is not without significance, in this connection, that the Newark, New Jersey school system apparently had little difficulty in correctly identifying eligible schools in the school year following those for which the auditors noted misexpenditures. *See* N.J.J.A. at 26 (Final Audit Report).

[53] Pub. L. No. 89-10, § 2 [adding § 205(a)(1)(A)], 79 Stat. 27, 30, *reprinted in* 1965 U.S. Code Cong. & Ad. News 29, 33 (codified at 20 U.S.C. § 241e(a)(1)(A) (Supp. IV 1968)).

[54] *See, e.g.*, 111 Cong. Rec. 7353 (daily ed., April 9, 1965) (Sen. Morse, floor manager) ("I wish to clarify [the permitted use of Title I funds] as a matter of legislative history. . . . The funds in Title I must be used to help the educational needs of educationally deprived children, not to remove any State responsibility from any State in providing education for its children").

[55] *See* 45 C.F.R. § 116.17(f) (1966).

issue here, the regulatory language referred unmistakably to providing a fair share of state and local resources to *participating children*, as well as *project areas*.[56] As in the case of eligibility criteria, federal authorities explained the implications of the non-supplanting requirement with great specificity and clarity.[57]

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[56] *See* 45 C.F.R. § 116.17(h) (1968):

> Each application for a grant under Title I of the Act for educationally deprived children residing in a project area shall contain an assurance that the use of the grant funds *will not result in a decrease in the use for educationally deprived children residing in that project area* of State or local funds which, in the absence of funds under Title I of the Act, would be made available for the project area and that *neither the project area nor the educationally deprived children residing therein will otherwise be penalized* in the application of State and local funds because of such a use of funds under Title I of the Act.

(emphasis supplied.) *See also* Program Guide No. 44, *supra* note 51, § 7.1 ("It is expected that services provided within the district with State and local funds will be made available to all attendance areas *and to all children* without discrimination") (emphasis supplied).

[57] Title I Program Guide No. 48, issued November 20, 1968 by Commissioner Howe, explicitly covered the sort of situation which developed in the 50 Kentucky school districts in 1974 and indicated that a contribution of state or local funds would be required to avoid supplanting:

> 3. Design a comprehensive program that will meet the most pressing needs of each child in the priority groups, utilizing all available local, State and Federal resources;
>
> . . . .
>
> As indicated in item 3 above, the entire school program in the project for the disadvantaged children involved. *State and local funds would then be used to pay for that portion of the program which would replace the pre-existing regular school program and Title I funds would be used to pay for additional services above that level.*

Id. at 2 (emphasis supplied). Separate Program Guides and memoranda were issued by the Commissioner explaining the comparability requirement, *see supra* note 39 & accompanying text.

Nevertheless, the occurrence of supplanting was widespread in the early years of the Title I program, a fact that was brought to the attention of the Congress by both the U.S. Office of Education and outside groups.[58] As a result, in 1970 specific language prohibiting supplanting was added to the statute itself. That language referred to the continuation of state and local spending "for the education of pupils participating in programs and projects assisted under this title."[59] While we think that that language, standing alone, is sufficiently definite and precise to have put Kentucky on notice of the impropriety of the "readiness class" expenditures, *see supra* p. 20, there simply could be no misunderstanding of its significance in light of the substantial attention given to the concept throughout the history of the Title I program. For the same reason, it is obvious that the Secretary's interpretation of the statutory and regulatory non-supplanting language which was applied to the Kentucky audit was no *post hoc* reading, as the Court of Appeals seemed to suggest.[60]

In both these cases, then, not only is the Secretary's interpretation of the statute and regulations amply supported by the language and legislative history, but the states received repeated and specific notice of that interpretation long before the events that produced the audit exceptions.

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[58] *See* S. Rep. No. 634, 91st Cong., 2d Sess. 9, *reprinted in* 1970 U.S. Code Cong. & Ad. News 2768, 2776, referring to Washington Research Project, et al., *Title I of ESEA: Is It Helping Poor Children?* (1969).

[59] Pub. L. No. 91-230, § 109(a), 84 Stat. 121, 124, *reprinted in* 1970 U.S. Code Cong. & Ad. News 133, 137 (codified at 20 U.S.C. § 241e(a)(3) (1970)). *See also supra*, text at note 39.

[60] *See supra* note 42.

CONCLUSION

For the foregoing reasons, *amicus* respectfully suggests that the judgments of the Court of Appeals for the Third and Sixth Circuits in these matters should be reversed.

Respectfully submitted,

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PETITIONER'S

BRIEF

No. 83-1798

In the Supreme Court of the United States

OCTOBER TERM, 1984

T.H. BELL, SECRETARY OF EDUCATION, PETITIONER

v.

KENTUCKY DEPARTMENT OF EDUCATION

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE PETITIONER

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QUESTION PRESENTED

Under a decision of the Secretary of Education interpreting Title I of the Elementary and Secondary Education Act of 1965 (20 U.S.C. (1976 ed.) 241a *et seq.*) and regulations issued thereunder, the Commonwealth of Kentucky misspent a portion of its Title I grant. The court of appeals concluded that the Secretary's interpretation of the statutory and regulatory requirements was reasonable and could be applied prospectively. However, the court held that the Secretary's interpretation could not be applied retroactively to require repayment of the misspent federal funds, since the statute and regulations were not unambiguous and the State's position was also reasonable.

The question presented is whether the right of federal agencies to recoup misspent grant funds is limited to cases in which no reasonable argument can be adduced to justify the expenditure.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-16a) is reported at 717 F.2d 943. The decisions of the Education Appeal Board and the Secretary of Education (Pet. App. 17a-42a) are unreported.

JURISDICTION

The judgment of the court of appeals (Pet. App. 43a) was entered on September 14, 1983, and a petition for rehearing was denied on December 5, 1983 (Pet. App. 44a). On February 28, 1984, Justice O'Connor extended the time for filing a petition for a writ of certiorari to and including May 3, 1984.

The petition was filed on that date and was granted on October 1, 1984 (J.A. 34). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTE AND REGULATION INVOLVED

Title I of the Elementary and Secondary Education Act of 1965, 20 U.S.C. (1976 ed.) 241e(a)(3)(B), provided in relevant part: [1]

> Federal funds made available under this subchapter will be so used (i) as to supplement and, to the extent practical, increase the level of funds that would, in the absence of such Federal funds, be made available from non-Federal sources for the education of pupils participating in programs and projects assisted under this subchapter, and (ii) in no case, as to supplant such funds from non-Federal sources.

45 C.F.R. 116.17(h) (1974) provided in relevant part:

> Each application for a grant * * * shall contain an assurance that the use of the grant funds will not result in a decrease in the use for educationally deprived children residing in that project area of State or local funds which, in the absence of funds under Title I of the Act, would be made available for that project area and that neither the project area nor the educationally deprived children residing therein will otherwise be penalized in the application of State and local funds because of such a use of funds under title I of the Act. * * * Federal funds made available for that [Title I] project (1) will be used to supplement, and to the extent practical increase, the level of State and local funds that would, in the absence of such Federal funds, be made available for the education of pupils participating in that project; (2) will not be used to supplant State and local funds available for the education of such pupils.

[1] Title I has been revised on several occasions since its original enactment. The statute and regulations in effect during Fiscal Year (FY) 1974, the year involved in this case, is set forth in the text. Title I was amended and reorganized in the Education Amendments of 1978 (20 U.S.C. 2701 *et seq.*) and superseded by Chapter 1 of the Education Consolidation and Improvement Act of 1981 (20 U.S.C. 3801 *et seq.*). This subsequent legislation does not affect the issues in this case.

STATEMENT

1. Title I of the Elementary and Secondary Education Act of 1965, 20 U.S.C. (1976 ed.) 241a *et seq.*, was enacted to provide federal financial assistance for programs "which contribute particularly to meeting the special educational needs of educationally deprived children" in areas where there are high concentrations of children from low-income families (20 U.S.C. (1976 ed.) 241a). Title I funds are thus intended to benefit a specific group of children—educationally deprived children in low-income areas—and are to be used to address their special needs by supplementing their regular school programs.[2]

[2] The Title I program has proven to be a highly successful federal education effort. Not only have the resources of the program been effectively brought to bear on "areas with the highest proportions of low-income children" (H.R. Rep. 95-1137, 95th Cong., 2d Sess. 5 (1978)), but the program has been "extremely effective in enhancing the achievement of participating students" (*id.* at 6). "Title I funds are indeed being used to provide special additional services to eligible children and * * * the program is making an important contribution to the educational experiences of disadvantaged children" (*ibid.*).

In 1970, in response to concerns that Title I funds were being used to replace state and local funds that otherwise would have been spent for participating children (S. Rep. 91-634, 91st Cong., 2d Sess. 9, 14-15 (1970)), Congress added a provision requiring that Title I funds be used only to supplement the level of funds that would, in the absence of Title I funding, "be made available from non-Federal sources for the education of pupils participating in programs and projects assisted under [Title I]" (20 U.S.C. (1976 ed.) 241e(a)(3)(B)(i)). The provision emphasized that in no case could Title I funds be used "to supplant such funds from non-Federal sources" (20 U.S.C. (1976 ed.) 241e(a)(3)(B)(ii)).[3]

The Secretary of Education[4] acts through state educational agencies (SEAs) to distribute Title I funds to local educational agencies (LEAs), which provide the supplemental programs. In order to participate in the Title I program, an SEA must assure the Secretary that Title I funds will be expended only for programs that meet all applicable statutory

[3] The supplanting prohibition for the current Chapter 1 program (see note 1, *supra*) is in 20 U.S.C. 3807(b). See also 34 C.F.R. 200.62.

[4] On May 4, 1980, the Department of Education replaced the Office of Education of the Department of Health, Education, and Welfare as the federal agency responsible for the Title I program, and the Secretary of Education assumed the responsibilities and authorities over this program that were previously exercised by the Commissioner of Education. See 20 U.S.C. 3411, 3441. For purposes of this brief, we will refer to the Department of Education and the Secretary of Education, even though most of the events surrounding this case occurred prior to 1980.

and regulatory requirements and have been approved by the SEA. 20 U.S.C. (1976 ed.) 241f(a)(1). An LEA may receive Title I funds from the SEA only on the basis of a project application in which the LEA describes how the funds will be expended and provides satisfactory assurances that it will comply with the statutory and regulatory requirements. See 20 U.S.C. (1976 ed.) 241e(a). The total amount of funds that an LEA receives under the Title I program is determined by a formula based on the number of children from low-income families in the area served by the LEA and the state per pupil expenditure. 20 U.S.C. (1976 ed.) 241c.

Under a specific delegation of rulemaking authority (see 20 U.S.C. (1976 ed.) 241e(a), 242(b)), the Secretary has promulgated regulations to ensure that Title I funds will be used only to provide supplemental assistance to the target population of educationally deprived children in low-income areas. In FY 1974 (the year involved in this case), the regulations specified that children could qualify for Title I services only if they needed "special educational assistance in order that their level of educational attainment [would] be raised to that appropriate for children of their age" (45 C.F.R. 116.1(i), 116.17(a) (1974)), and if they resided in a school attendance area with a high percentage of low-income children (45 C.F.R. 116.17(a), 116.17(d) (1974)). The regulations also required grant applications submitted by LEAs to contain an assurance that the Title I funds would not cause "a decrease in the use for educationally deprived children residing in [the] project area of State or local funds which, in the absence of [Title I] funds * * *, would be made available for that project area and

that neither the project area nor the educationally deprived children residing therein will otherwise be penalized in the application of State and local funds because of such a use of [Title I] funds" (45 C.F.R. 116.17(h) (1974)). The regulations further required that Title I funds in fact be used to supplement the state and local funds that would otherwise be "made available for the education of pupils participating in [the Title I] project" (45 C.F.R. 116.17 (h)(1) (1974)), and not "to supplant State and local funds available for the education of such pupils" (45 C.F.R. 116.17(h)(2) (1974)).

2. In order to ensure that Title I funds are being expended properly in accordance with applicable statutory and regulatory requirements, Congress has required the Secretary to conduct post-expenditure audits. 20 U.S.C. (1976 ed.) 1232c; see also 5 U.S.C. App. 1-12, at 987-993; 20 U.S.C. 2835. If an audit discloses that funds have been misspent, the Department of Education demands restoration of the misspent funds. See *Bell* v. *New Jersey*, No. 81-2125 (May 31, 1983). Audits of Title I programs have been conducted continuously since the late 1960's, and Congress recognized as early as 1970 that misspent Title I funds discovered during these audits must be refunded to the Department. S. Rep. 91-634, *supra*, at 83-84. Congress thus expected the Secretary to "exercise fully his authority and responsibility under the law to see that State agencies abide by the assurances they have given" (*id.* at 10) and to recover any "improperly used funds" (*id.* at 84).

If an administrative determination is made that Title I funds have been misspent, the state may file an application for review with the Education Appeal Board (EAB). The EAB was established to provide

states and other grantees of federal education funds with an opportunity to appeal audit findings and other adverse determinations to an impartial administrative tribunal. 20 U.S.C. 1234-1234d.[6] Under the statute governing the EAB, the "burden shall be upon the State * * * to demonstrate the allowability of [questioned] expenditures" (20 U.S.C. 1234a(b)). A decision of the EAB becomes final unless it is modified or set aside by the Secretary. 20 U.S.C. 1234a(d). The state may seek judicial review of the Secretary's final decision in the appropriate federal court of appeals (20 U.S.C. 1234d, 2851), but the Secretary's findings of fact are conclusive if supported by substantial evidence. 20 U.S.C. 1234d(e), 2851(b).

3. a. The present dispute arose when auditors from the Department of Health, Education, and Welfare (see note 4, *supra*) determined that, during FY 1974, 50 LEAs in the Commonwealth of Kentucky had spent $704,237 in violation of the prohibition against using Title I funds to supplant state and local funds. J.A. 11-21. At issue were federally funded "readiness" classes run by these LEAs for children who were not prepared to enter first or second grade. In contrast to Title I programs in other states, which typically provided serv-

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[6] The creation of the EAB was mandated by Congress in the Education Amendments of 1978 (Pub. L. No. 95-561, 92 Stat. 2153). See 20 U.S.C. 1234(a). Prior to the establishment of the EAB, states could appeal adverse Title I audit determinations to the Title I Audit Hearing Board. Effective June 29, 1979, the Title I Audit Hearing Board was replaced by the EAB, which assumed jurisdiction over 31 pending Title I audit appeals, including the appeal by Kentucky that is the subject of the instant action. 44 Fed. Reg. 30528-30537 (1979); 44 Fed. Reg. 43807 (1979).

ices a few hours a week in a specific area of educational need, the readiness classes were full day programs. J.A. 16. The classes were similar to preschool programs, except that the children were formally enrolled in first or second grade and a substantial portion of the children were expected to move on to the next grade level following their year of readiness instruction. J.A. 16-17. All of the readiness classroom instructional salaries, and some administrative support costs, were funded with Title I, not state or local, monies. Pet. App. 22a. The children in these classes received the same locally-funded "enrichment" services (*e.g.*, physical education, library, art and music) as children enrolled in regular first and second grade classes.

Approximately $1.65 million of Title I funds was expended for these programs during FY 1974. J.A. 14. In a final audit report sent to respondent on October 29, 1976, the auditors concluded that federal funding had replaced the state and local funds that would otherwise have been spent on first or second grade for the children in the readiness classes who were promoted to the next grade level in the following year. J.A. 17. The auditors calculated that $704,237 of the $1.65 million had been used improperly in place of state and local funds. *Ibid.*

The State disagreed with the auditors' findings, essentially on the ground that there had been no decrease in state and local funding of the *schools* or *grade levels* involved. The State took the position that this was sufficient compliance with the supplanting prohibition, and that the federal statute and regulations should not be interpreted to require maintenance of state and local funding for the particular *children* enrolled in the Title I program. J.A. 18-19.

After administrative review, the Deputy Commissioner for Elementary and Secondary Education issued a final determination letter sustaining the auditors' findings and demanding repayment of the $704,237 that was determined to have been misspent. J.A. 22-23.

The State filed an application for review with the Title I Audit Hearing Board and, after extensive administrative proceedings, the successor EAB (see note 5, *supra*) issued an initial decision sustaining the auditors' findings (Pet. App. 17a-32a). Because it was "undisputed factually that State and local funds were not expended for the basic instructional costs of Title I readiness pupils" (Pet. App. 24a), the EAB concluded that Title I funds had been used to supplant state and local funds that otherwise would have been spent on the participating pupils who were promoted to the next grade level in the following year. The EAB specifically rejected the State's argument that the supplanting prohibition was satisfied as long as there was no decrease in state and local funding of the schools or grade levels involved, because "the statutory and regulatory provisions are sufficiently clear in their emphasis on the expenditure of funds for pupils—not LEA's, schools, or grade levels" (*ibid.*). The EAB found that "[t]he regulatory provision is * * * clear [on this issue], even to the point of repetition" (*id.* at 25a (footnote omitted)). Indeed, the EAB pointed out that "by maintaining State and local funds at the grade level while Title I paid for instructional costs of the readiness program, the SEA and the LEA's assured that additional State and local funds were devoted to *non-Title I* pupils—funds which in the absence of Title I would have paid for the instruction of the education-

ally deprived children" (*id.* at 24a (emphasis added)).

Consequently, the EAB decided that the readiness programs "were not properly designed to supplement state and local expenditures for Title I children, that a supplanting violation did occur, and that the full $704,237 must be refunded by the SEA" (Pet. App. 19a). The State then sought review by the Secretary, who remanded to the EAB for further consideration (*id.* at 33a-35a). Following the EAB's reaffirmance of its initial decision (*id.* at 36a-37a), the Secretary again considered the case. The Secretary upheld the determination that a violation of the supplanting prohibition had occurred, but he reduced to $338,034 the amount the State was required to repay. Pet. App. 38a-42a.[6]

b. The State appealed to the court of appeals pursuant to 20 U.S.C. 1234d and 2851. The court of appeals sustained the Secretary's interpretation of the supplanting prohibition (Pet. App. 8a-9a (footnote omitted)):

> It cannot be said that the interpretation posited by the Secretary is "unreasonable." The statutory and regulatory prohibitions against supplanting State and local funds with Title I funds can reasonably be applied with reference to expenditures at the level of the individual educationally deprived pupil, rather than at the level of either the LEA, the school, the grade, or the classroom.

[6] This reduction reflected the Secretary's determination that the pupil-teacher ratio in the readiness classes (13:1) was substantially smaller than the ratio prevailing elsewhere in the State (27:1). The Secretary concluded that the children in readiness classes had therefore received some benefit beyond what they would have received from the regular program, and that a pro rata state-federal allocation of the readiness class costs, reflecting the improved pupil-teacher ratio, was an appropriate way to calculate this benefit. Pet. App. 3a, 38a-42a.

Nevertheless, relying on *Pennhurst State School & Hospital* v. *Halderman*, 451 U.S. 1 (1981), the court of appeals concluded that the Secretary's interpretation could not be applied to require the repayment of funds spent by respondent in violation of Title I, because "the statutory and regulatory provisions at issue were [not] sufficiently clear to apprise the Commonwealth of its responsibilities" (Pet. App. 9a-10a). In particular, the court held that "[w]here, as here, a determination of whether Title I funds supplant or supplement State and local funds depends upon whether the focus is on the district or the pupil, the statute and regulations cannot be said to be unambiguous" (Pet. App. 15a). The court accordingly concluded (*id.* at 12a (footnote omitted)):

> This is not to say that the interpretation * * * posited by the Commonwealth is controlling. On the contrary, the interpretation of the Secretary governs all future dealings. We hold only that in the absence of unambiguous statutory and regulatory requirements, and in the presence of a specific grant of discretion to the Commonwealth to develop and administer programs it believes to be consistent with the intentions of Title I, it is unfair for the Secretary to assess a penalty against the Commonwealth for its purported failure to comply substantially with the requirements of law, where there is no evidence of bad faith and the Commonwealth's program complies with a reasonable interpretation of the law.

SUMMARY OF ARGUMENT

I. This Court has consistently applied the "venerable principle that the construction of a statute by those charged with its execution should be followed unless there are compelling indications that it is wrong." *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1969). This principle has special force where, as here, "Congress entrusts to the Secretary * * * the primary responsibility for interpreting the statutory term." *Batterton* v. *Francis*, 432 U.S. 416, 425 (1977). In that circumstance, "[a] reviewing court is not free to set aside those regulations simply because it would have interpreted the statute in a different manner." *Ibid.*

The court of appeals ignored these fundamental precepts of administrative law. Without identifying any legal basis for its ruling, the court excused respondent's failure to comply with the Secretary's reasonable interpretation of the anti-supplanting provisions of the Title I statute and regulations, stating only that respondent did not act in bad faith in adopting its own reasonable interpretation of an allegedly ambiguous requirement. This limitation on the principle requiring judicial deference to an agency's reasonable construction of its governing statute is without support in policy or precedent and is inconsistent with the language and legislative history of Title I.

This Court has repeatedly recognized the unconditional right of the federal government to recover monies erroneously paid or used for an improper purpose. Title I and its legislative history specifically support the strict enforcement of basic Title I requirements, such as the supplanting prohibition at issue here, and the recovery of any funds that are

spent in contravention of those requirements. *Bell v. New Jersey*, No. 81-2125 (May 31, 1983). The standard adopted by the court of appeals, however, substantially eviscerates the established right of the federal government to recover misspent grant funds and undermines the ability of federal agencies to ensure scrupulous compliance with grant programs. In effect, the court's decision, instead of requiring grantees to seek clarification of ambiguous regulations before expending federal funds, invites them to adopt their own relaxed interpretations of federal expenditure restrictions and to resist audit exceptions whenever some interpretation can be devised to justify an erroneous expenditure.

Nothing in *Pennhurst State School & Hospital* v. *Halderman*, 451 U.S. 1 (1981), supports this unfortunate result. *Pennhurst* involved the potential imposition of large, indeterminate financial burdens on states as a condition for the receipt of modest amounts of federal grant funds. By contrast, the present case involves only the proper use of federal grant funds, and the State's potential liability is limited to repaying the amount of federal funds that have been misspent. Moreover, unlike the situation in *Pennhurst*, compliance with the legal requirement at issue here was an unmistakable statutory condition on the receipt of Title I funds.

II. The adverse effect of the court of appeals' limitation on the government's right to recover misspent grant funds is exacerbated by the exceedingly low standard of reasonableness it applied in concluding that respondent's interpretation of the Title I statute and regulations was reasonable. The express terms of the supplanting prohibition provide that Title I funds may not be used to replace state and

local funds that, in the absence of the Title I program, would have been expended on participating *children*. The operation of a Title I program in contravention of this basic requirement serves to defeat the statutory purpose of providing supplemental services to educationally deprived children residing in low-income areas, for whose benefit Title I was enacted, and cannot be considered "substantial compliance" with the conditions imposed upon receipt of the federal funds.

ARGUMENT

GRANTEES OF FEDERAL FUNDS ARE OBLIGATED TO REPAY AMOUNTS SPENT IN VIOLATION OF APPLICABLE STATUTES AND REGULATIONS, AS REASONABLY CONSTRUED BY THE AGENCY CHARGED WITH ADMINISTRATION OF THE GRANT PROGRAM

I. THE COURT OF APPEALS APPLIED AN ERRONEOUS STANDARD OF REVIEW BY DEFERRING TO THE STATE'S INTERPRETATION OF THE TITLE I ANTI-SUPPLANTING PROVISIONS

In reversing the decision of the Secretary, the court of appeals adopted an incorrect standard of review that severely restricts the ability of federal agencies to recoup misspent federal grant funds. Rather than limiting its inquiry to determining the reasonableness of the Secretary's interpretation of Title I, the court below chose to defer to the *grantee's* view of allegedly ambiguous statutory and regulatory requirements. In other words, unless there is evidence of bad faith, or the provisions at issue are "unambiguous," a grantee need only "substantially" comply with "a reasonable interpretation of the law" (Pet. App. 12a). Accordingly, the well established right of federal agencies to recoup misspent grant

funds would be limited to those rare instances in which the grantee cannot present any reasonable argument to justify an expenditure. This approach cannot be reconciled with the proper standard of judicial review of administrative action and would greatly undermine the administration of federal grant programs.

A. The Secretary's Decision Should Have Been Upheld Because It Was Based On A Reasonable Interpretation Of The Title I Statute And Regulations

The validity of the contested Title I expenditures in this case depended entirely upon whether the anti-supplanting provisions in the Title I statute and regulations "applied with reference to expenditures at the level of the individual educationally deprived pupil" or "at the level of either the LEA, the school, the grade, or the classroom" (Pet. App. 9a). On that question, the court of appeals found that both the Secretary's (*id.* at 8a-9a) and respondent's (*id.* at 12a) interpretations of the anti-supplanting provisions were reasonable. It concluded that while the Secretary's interpretation would "govern[] all future dealings" (*ibid.*), respondent could not be required to repay the disputed FY 1974 sums, evidently on the ground that respondent's interpretation controlled past expenditures. Thus, in the guise of developing "substantive standards" for reviewing the Secretary's determination (*id.* at 5a), the court departed from the clearly established standards that control judicial review of administrative action.[7]

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[7] The court of appeals incorrectly believed that this case involved the "significant issue" identified in Justice White's concurrence in *Bell* v. *New Jersey*, slip op. 2: "whether a State can be required to repay if it has committed no more than a

As the Court noted in *Bell* v. *New Jersey*, No. 81-2125 (May 31, 1983), slip op. 3, Congress has authorized "judicial review in the courts of appeal of the Secretary's final action with respect to audits" under the Title I program. The standards that govern judicial review of such final administrative determinations are well settled. "The findings of fact by the Secretary, if supported by substantial evidence, shall be conclusive" (20 U.S.C. 2851(b); see also 20 U.S.C. 1234d(c)). As to questions of law, this Court has consistently held that "the construction of a statute by those charged with its execution should be followed unless there are compelling indications that it is wrong." *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1967). See *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, No. 82-1005 (June 25, 1984), slip op. 6-7 & n.14. The Court has explained that a reviewing court "need not find that [the agency's] construction is the only reasonable one, or even that it is the result [the court] would have reached had the question arisen in the first instance in judicial proceedings. * * * All that is needed to support the [agency's] interpretation is that it has 'warrant in the record' and a 'reasonable basis in law'." *Unemployment Compensation Comm'n* v. *Aragon*, 329 U.S. 143, 153-154 (1946), quoting *NLRB* v. *Hearst Publications, Inc.*, 322 U.S.

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technical violation of the agreement or if the claim of violation rests on a new regulation or construction of the statute issued after the state entered the program and had its plan approved." As explained below (pages 37-38, *infra*), the violation here was hardly "technical," and the Department's regulation construing the statute antedated the SEA's approval of the contested plans (see Pet. App. 6a, 10a n.9).

111, 131 (1942).[8] See *FEC* v. *Democratic Senatorial Campaign Committee*, 454 U.S. 27, 39 (1981); *Zenith Radio Corp.* v. *United States*, 437 U.S. 443, 450 (1978).[9]

If the court of appeals had applied this principle it would have upheld the Secretary's right to recover the misspent funds at issue here. There was substantial evidence in the record to support recoupment:

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[8] Not surprisingly, other courts of appeals have followed this principle in accepting the Secretary's interpretation of statutory and regulatory requirements in Title I audit cases. See *Indiana* v. *Bell*, 728 F.2d 938, 941 (7th Cir. 1984); *West Virginia* v. *Secretary of Education*, 667 F.2d 417, 420 (4th Cir. 1981).

[9] Judicial deference to the agency interpretation is particularly appropriate here. The Secretary was expressly authorized to establish "basic criteria" to govern the SEA's determination that an LEA grant application provided satisfactory anti-supplanting assurances (20 U.S.C. (1976 ed.) 241e(a) and (3); see also 20 U.S.C. (1976 ed.) 242(b)). When there is such a specific delegation of rulemaking authority, "Congress entrusts to the Secretary, rather than to the courts, the primary responsibility for interpreting the statutory term. In exercising that responsibility, the Secretary adopts regulations with legislative effect. A reviewing court is not free to set aside those regulations simply because it would have interpreted the statute in a different manner" *Batterton* v. *Francis*, 432 U.S. 416, 425 (1977). See also *United States* v. *Morton*, No. 83-916 (June 19, 1984), slip op. 11-12; *Schweiker* v. *Gray Panthers*, 453 U.S. 34, 44 (1981).

Congress's confidence in administrative expertise in this area is further evidenced both by its reliance on information developed by the agency to establish the need for a specific statutory anti-supplanting provision (S. Rep. 91-634, *supra*, at 9) and by its direction to the Secretary to "exercise fully his authority and responsibility under the law" to police that provision and others designed to control improper use of grant funds (*id.* at 10).

it was "basically uncontested" (Pet. App. 21a) that $338,034 of Title I funds had been used in lieu of state and local funds that otherwise would have been spent on the participating children. Moreover, the court of appeals explicitly stated that the Secretary reasonably interpreted the statutory and regulatory provisions in effect in FY 1974 as prohibiting supplanting "at the level of the individual educationally deprived pupil," even if the non-Title I funding for "the LEA, the school, the grade, or the classroom" remained the same (Pet. App. 8a-9a). Accordingly, "[t]he judicial function [was] exhausted when there [was] found to be a rational basis for the conclusions approved by the administrative body." *Mississippi Valley Barge Line Co.* v. *United States*, 292 U.S. 282, 286-287 (1934).

Although the court of appeals gave lip service to the principle of deference (Pet. App. 8a-9a n.6), the court found the principle inapplicable, apparently on the theory that it applied only to "future dealings," not to the determination of the propriety of the 1974 expenditures. The court cited no authority for this limitation on the scope of the principle, and we are aware of none. This Court has never suggested that less deference is due to an agency interpretation of the statute it administers when the interpretation governs conduct occurring before the judicial ruling.[10] Litigation frequently involves such interpreta-

[10] See *Lange* v. *United States*, 443 F.2d 720, 724 (D.C. Cir. 1971) ("The gears of government must mesh without awaiting final judicial precedent, and the officials concerned must construe the statutes they administer. When the practice they launch and continue is not unreasonable or contrary to ascertainable legislative intent the courts will give it weight in deciding statutory intent.").

tions, as did the two cases most often cited for the principle, *Red Lion Broadcasting Co.* v. *FCC*, *supra*, and *Udall* v. *Tallman*, 380 U.S. 1, 16 (1965).[11]

Despite this clear authority requiring deference to the Secretary's reasonable interpretation of the anti-supplanting provisions, the court of appeals focused on whether respondent's interpretation was also reasonable, and, on finding that it was, gave it controlling effect for the period in dispute. This ap-

[11] The court of appeals' refusal to apply the Secretary's interpretation to the 1974 expenditures cannot be justified on the theory that those expenditures were made before the *agency* had clarified its position. See page 34, *infra*; Pet. App. 10a n.9. But even if the scope of the anti-supplanting requirement had not been clear when the expenditures were made, that would not have prevented the Secretary from establishing the standards for expenditures through adjudicatory rulings in audit cases rather than through rulemaking. This Court has repeatedly rejected the argument that an agency must employ rulemaking rather than adjudication to articulate new legal standards. *NLRB* v. *Bell Aerospace Co.*, 416 U.S. 267, 290-295 (1974); *NLRB* v. *Wyman-Gordon Co.*, 394 U.S. 759, 765-766, 772 (1969); *SEC* v. *Chenery Corp.*, 332 U.S. 194, 200-203 (1947). No regulatory scheme can address specifically every factual situation that may arise. Accordingly, so long as the adjudication does not produce "substantial inequitable results" (*Chevron Oil Co.* v. *Huson*, 404 U.S. 97, 107 (1971), quoting *Cipriano* v. *City of Houma*, 395 U.S. 701, 706 (1969)), the agency may properly decide to proceed by adjudication. The Secretary's application of the anti-supplanting provision produced no such results, and there is no retroactivity problem here. The agency certainly did not "overul[e] clear past precedent on which [the states] may have relied or * * * decid[e] an issue of first impression whose resolution was not clearly foreshadowed" (*Chevron Oil Co.* v. *Huson*, 404 U.S. at 106 (citations omitted)). Instead, it merely applied the fundamental principles behind the anti-supplanting provision (see pages 32-38, *infra*) to the specific factual situation presented by the Kentucky readiness program.

proach turned the proper standard for judicial review on its head. Cf. *Consolo* v. *Federal Maritime Commission*, 383 U.S. 607, 618-619 (1966) (court of appeals improperly reversed agency determination after concluding that substantial evidence supported conclusion contrary to that reached by the agency).

B. The Title I Statute And Legislative History Do Not Support The Court Of Appeals' Limitations On The Secretary's Recoupment Authority

This Court has long recognized that the federal government possesses the unconditional right to recover monies erroneously paid or used for an improper purpose. See *United States* v. *Wurts*, 303 U.S. 414, 415 (1938); *Grand Trunk W. Ry.* v. *United States*, 252 U.S. 112 (1920); *Wisconsin Cent. R.R.* v. *United States*, 164 U.S. 190 (1896); *United States* v. *Carr*, 132 U.S. 644 (1890); *United States* v. *Barlow*, 132 U.S. 271, 281-282 (1889); *United States* v. *Burchard*, 125 U.S. 176, 180-181 (1888). This right is abrogated or limited only when Congress has clearly manifested its intention to do so. *United States* v. *Wurts*, 303 U.S. at 416. None of these cases suggests that recoupment is contingent on proof other than the erroneous nature of the payment or the impropriety of an expenditure. In particular, there is no suggestion in any decision of this Court that the government must demonstrate "bad faith" or "unambiguous" requirements, or that "substantial" compliance with "a reasonable interpretation of the law" is sufficient to defeat the government's claim to recover misspent federal funds. Consequently, the court of appeals erred in imposing these conditions unless they can be justified on the basis of the Title I statutory scheme.

They cannot. In fact, the statute and its legislative history demonstrate that Title I requirements are to be strictly enforced, and that the Secretary must recover any misspent funds. The specific statutory provisions authorizing the recovery of misspent Title I funds do not place any conditions on the right of recovery. See 20 U.S.C. 1226a-1, 1234a(e), 2835. These provisions do not provide that, to recoup misspent funds, the Secretary must demonstrate "bad faith" or a violation of "unambiguous" requirements. And, contrary to the court of appeals' suggestion (Pet. App. 9a n.8, 16a), there is no "substantial compliance" test in the Title I audit provisions.[12] The provisions noted by the court of appeals, 20 U.S.C. 1234b(a) and 1234c(a), authorize the Secretary to *withhold* grant funds and to issue cease-and-desist orders when a recipient of federal funds has failed to "comply substantially" with federal requirements. By contrast, the provisions authorizing the Secretary to make *audit* determinations do not contain a "substantial compliance" standard.[13]

The statutory distinction between the standards applicable to withholding or cease-and-desist proceedings on the one hand, and audit proceedings on the other, is based on their different practical effects. While withholding and cease-and-desist proceedings

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[12] Even if the substantial compliance test applied to audit claims, it would not justify the decision of the court of appeals. See pages 37-39, *infra*.

[13] Indeed, Congress recently rejected a proposal to amend the audit provisions to add such a standard. The proposed amendment was contained in Section 808(a) of H.R. 11, 98th Cong., 2d Sess. (1984) (see 130 Cong. Rec. H7902-H7903 (daily ed. July 26, 1984), but was deleted in conference (see 130 Cong. Rec. H10756 (daily ed. Oct. 2, 1984)).

may result in serious disruption of ongoing programs, to the immediate detriment of program participants, settlements of audit claims involve only after-the-fact adjustments of accounts. It is both programmatically and fiscally sound to apply a more lenient standard of review in the former context, to avoid sudden disruptions in the Title I program, yet at the same time to hold the grantee ultimately responsible for the expenditure of all Title I funds in strict compliance with the statutory and regulatory requirements to which it agreed when it accepted the funds.

The legislative history confirms the congressional intent to require strict compliance with the statutory grant conditions. The Senate Report stated that the Secretary must "exercise fully his authority and responsibility under the law to see that State agencies abide by the assurances they have given." S. Rep. 91-634, *supra*, at 10.[14] The Report added that, "[e]ven though there may be difficulties arising from recovery of improperly used [Title I] funds, those exceptions must be enforced" (*id.* at 84). See also 20 U.S.C. 1234a-1234c. As this Court recognized in *Bell* v. *New Jersey*, *supra*, the recapturing of excess or misused Title I funds by the Department was viewed as " 'an essential condition for enacting the • • • legislation' " (slip op. 9, quoting 111 Cong. Rec. 7690 (1965)), and the debates in the House when Title I was enacted "suggested • • • a concern and a desire to hold the States accountable in every way possible" (*Bell* v. *New Jersey*, slip op. 9 n.9).

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[14] The Senate Report identified "[t]he supplanting of state and local funds with title I funds" as an area in which state supervision was lax, and thus where federal enforcement was particularly necessary. S. Rep. 91-634, *supra*, at 9-10.

Subsequent events reinforce this evidence of legislative intent. Congress in 1978 ameliorated some of the "difficulties arising from recovery" of misspent funds by imposing a five-year statute of limitations on audit claims and by authorizing the compromise of claims of $50,000 or less, where collection is not practical or in the public interest and the practice that resulted in the claim has been corrected. 20 U.S.C. 1234a(g) and (f).[15] Significantly, Congress did not choose to include in this ameliorative legislation a "good faith" exception, or to place any other conditions on the recovery of misspent Title I funds. In fact, as part of this legislation, Congress specifically imposed on grantees the burden of "demonstrat[ing] the allowability of [questioned] expenditures" in administrative proceedings before the EAB. 20 U.S.C. 1234a(b). Thus, contrary to the court of appeals' approach of deferring to a grantee's reasonable interpretation of statutory and regulatory requirements, Congress sought to make grantees strictly account for and justify Title I expenditures subject to an audit claim.[16]

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[15] Congress also authorized the Secretary to return to the states up to 75% of the repaid funds where the practices that led to the misuse have been corrected and where the returned funds will, to the extent possible, be used to benefit the population affected by the misuse and will serve to achieve the purposes of the approved state program (20 U.S.C. 1234e(a)). This grantback authority has been exercised by the Secretary on numerous occasions. See, *e.g.*, 49 Fed. Reg. 34886-34887 (1984) (Rhode Island); 49 Fed. Reg. 13899-13900 (1984) (West Virginia); 49 Fed. Reg. 8474-8476 (1984) (South Carolina); 47 Fed. Reg. 20343-20345 (1982) (Wisconsin); 47 Fed. Reg. 23002-23003 (1982) (District of Columbia).

[16] The statue governing the EAB provides that "the burden shall be upon the State or local educational agency to

Thereafter, in 1981, the Senate considered an amendment to an appropriations bill that would have relieved the states of any obligation to repay Title I funds that were misspent before 1978. Although the amendment was ultimately defeated on a point of order (127 Cong. Rec. S5430 (daily ed. May 21, 1981)), the debate further confirms congressional recognition of the Secretary's unconditional authority to recover misspent Title I funds. In particular, it was expressly noted in these debates that the agency was seeking to recoup funds in instances where "[t]here has been no showing of bad faith or intentional misspending" (*id.* at S5428) or "fraud" (*id.* at S5430). There was no suggestion that the Secretary lacked legal authority to recover the funds in these circumstances.

Nor can the decision of the court of appeals be justified on the basis that "[t]he legislative history to Title I is replete with evidence that Congress left to the discretion of the participating States the responsibility to establish programs with Title I funds" (Pet. App. 10a-11a). Although Title I does leave to the states and LEAs the responsibility for determin-

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demonstrate the allowability of expenditures disallowed in the final audit determination" (20 U.S.C. 1234a(b)). It would be anomalous to place the burden of demonstrating the allowability of a questioned expenditure on the grantee in the administrative proceedings, but require deference to the grantee's interpretation of the law during subsequent judicial review. Under such a scheme, a grantee who fails to meet its burden at the administrative level may well prevail on judicial review under a more relaxed standard. That anomaly is avoided by requiring the courts to accord "deference to [the] congressionally prescribed standard[] of proof * * * in administrative proceedings" before the EAB (*Steadman* v. *SEC*, 450 U.S. 91, 95 n.9 (1981)).

ing the types of services to be offered (*e.g.*, whether funds should be used for reading, mathematics, or language arts instruction), it goes without saying that states and LEAs do not have the discretion to implement programs that violate basic statutory and regulatory requirements of the Title I program. Thus, while "the legislation left to local schools the decision as to what education methods are to be used in improving educational opportunities for educationally deprived children," it also contained "requirements * * * designed to insure that, whatever education methods are used, Federal funds are to be focused on the special educational needs of educationally deprived children" (S. Rep. 91-634, *supra*, at 8). See also H.R. Rep. 95-1137, 95th Cong., 2d Sess. 4 (1978); *Alexander* v. *Califano*, 432 F. Supp. 1182, 1189-1190 (N.D. Cal. 1977).[17] The legislative history cited by the court of appeals does not remotely suggest that a grantee may establish educational programs that use Title I funds to supplant state and

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[17] For example, the decision to use a "self-contained classroom procedure" rather than exposing the children involved to regular grades as well as the readiness program (Br. in Opp. 3-4) was clearly one reserved to the local authorities. But that decision did not justify the supplanting violation that occurred here, which relates only to the method by which the program was funded. Thus, the LEAs could have implemented precisely the same kind of unified program without any supplanting violation, if they had arranged the funding so that the participating children received their fair share of state and local educational funds. Title I funds could then properly have been used for any extra costs, over and above the state and local funds that should have been expended for these children, resulting from the implementation of the readiness program. It was the funding, not the educational structure of the program, that created the supplanting violation.

local funds that otherwise would have been spent on eligible children.

C. This Court's Decision In *Pennhurst State School & Hospital* v. *Halderman* Does Not Support The Court Of Appeals' Standard Of Judicial Review

Although the legal basis for the limitations that the court of appeals placed on the Secretary's recoupment authority is unclear, the court claimed to find support for its position in *Pennhurst State School & Hospital* v. *Halderman*, 451 U.S. 1 (1981). Nothing in that decision, however, supports the court of appeals' unprecedented standard of review.

Pennhurst involved the potential imposition of a "massive obligation" on states as a condition of their participation in a federal grant program under the Developmentally Disabled Assistance and Bill of Rights Act of 1975, 42 U.S.C. 6000 *et seq.* 451 U.S. at 24. The plaintiffs contended that the Act required that grant recipients provide mentally retarded persons with appropriate treatment in the least restrictive environment. While the grant program provided relatively modest federal funding to the participating state,[18] the state grantees' potential obligations under the plaintiff's view of the program were "largely indeterminate." *Ibid.* In this context, the Court held that "if Congress intends to impose a condition on the grant of federal moneys, it must do so unambiguously * * *. [This enables] the States to exercise their choice [of whether to participate in the grant program] knowingly, cognizant of the consequences of their participation." 451 U.S. at 17 (citations omitted).

[18] For example, Pennsylvania received $1.6 million under this program in 1976. 451 U.S. at 24.

The present case is quite different from *Pennhurst*. First, the supplanting prohibition is now, and was in 1974, an explicit statutory condition on the receipt of Title I funds. See 20 U.S.C. (1976 ed.) 241f(a)(1).[19] An LEA could receive a Title I grant only if the SEA determined that the LEA's application demonstrated compliance with this basic requirement. 20 U.S.C. (1976 ed.) 241e(a)(3)(B); see also 45 C.F.R. 116.17(h) (1974). Thus, in contrast to the situation in *Pennhurst*, where Congress "fell well short of providing clear notice to the States that they, by accepting funds under the Act, would indeed be obligated to comply with [the alleged condition]" (451 U.S. at 25), Congress here made compliance with the supplanting prohibition a specific condition on the receipt of Title I funds. See also S. Rep. 91-634, *supra*, at 14-15; *Bell* v. *New Jersey*, slip op. 16 n.17). No grantee could ever have reasonably thought otherwise.

Second, because Title I is totally funded by the federal government, this case involves only the use of federal funds, not an affirmative obligation imposed on a grantee to fund additional programs or services

[19] Unlike the situation in *Pennhurst*, where the federal agency's regulations did not support imposition of the condition in question (451 U.S. at 23), the Title I regulations have always required an assurance by the SEA that each application it approved would comply "with the requirements of Title I of the Act and the regulations in subpart C of this part." 45 C.F.R. 116.21(c) (1974). The Subpart C regulations included the supplanting prohibition in 45 C.F.R. 116.17(h) (1974). There accordingly was no ambiguity about the applicability of the anti-supplanting provision at the time respondent received its FY 1974 funds. If the SEA was uncertain about the precise meaning of that provision, of course, it could always have sought clarification from the Secretary. See Pet. App. 27a.

out of state or local funds.[20] While the states' potential obligations were "largely indeterminate" in *Pennhurst* (451 U.S. at 24), a grantee's liability under Title I is limited to repaying the Title I funds that were misspent. See *Heckler* v. *Community Health Services of Crawford County, Inc.*, No. 83-56 (May 21, 1984), slip op. 9-11. Moreover, whereas in *Pennhurst*, in light of the enormity of the potential state liability in comparison to the modest amount of grant funds provided, it "defie[d] common sense * * * to suppose that Congress * * * imposed [a] massive obligation on participating States" (451 U.S. at 24), the amount of the refund sought here by the Secretary is little more than 1% of the Title I funds granted to Kentucky for the year in question (Pet. App. 19a, 42a).

Third, *Pennhurst* involved an action brought by private plaintiffs, not an audit dispute between the federal government and a federal grantee. As Justice White explained in *Guardians Ass'n* v. *Civil Service Comm'n*, No. 81-431 (July 1, 1983), the federal government may always recover grant funds misspent by a recipient, but "it is an entirely different matter to subject the recipient to open-ended liability to private plaintiffs" (slip op. 20 n.24).

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[20] Title I does impose certain budgetary restrictions on state and local participants, such as the anti-supplanting provision involved in this case and the maintenance of effort and comparability requirements (see note 25, *infra*). However, these requirements only commit an LEA to maintain preexisting levels of expenditures for education from state and local sources, and not to use Title I funds to replace state and local funds that would otherwise have been spent on participating children. They do not require a state or LEA to expend any additional state resources as a condition for participation in the Title I program.

In sum, the State was able to make an informed decision to participate in the Title I program. The conditions for participation (including the supplanting prohibition) were set forth clearly in the statute and regulations, and the State only exposed itself to the potential liability of repaying any Title I funds that were misspent. As the Sixth Circuit correctly recognized in another case involving the Commonwealth of Kentucky, *Pennhurst* "involved the issue as to whether a particular grant of funds was conditional at all," not the precise meaning of clearly applicable conditions. *Kentucky* v. *Donovan*, 704 F.2d 288, 299-300 n.17 (1983). Accordingly, the circumstances that gave rise to the Court's decision in *Pennhurst* are not present here, and that decision cannot justify the inappropriate standard of review adopted by the court of appeals.

D. The Court Of Appeals' Standard Of Review Effectively Eviscerates The Secretary's Ability To Recover Misspent Title I Funds

In *Bell* v. *New Jersey*, *supra*, this Court unanimously held that the federal government may recover misspent funds "advanced as part of a federal grant-in-aid program under Title I of the Elementary and Secondary Education Act" (slip op. 1). The Court emphasized that states are required "to honor the obligations voluntarily assumed as a condition of federal funding" (slip op. 16) and that when a State fail[s] to fulfill those assurances * * * it [becomes] liable for the funds misused, as the grant specified" (slip op. 17). In view of this Court's ruling, the court of appeals acknowledged the right of the federal government "to recover misspent funds from states which had received grants under Title I" (Pet.

App. 4a) and stated that, "if supplanting occurred" here, "the Secretary has the authority to order a refund" (*ibid.*).

Despite this recognition in principle of the Secretary's right to recover misspent Title I funds, the court of appeals' standard of review effectively eviscerates that right by placing unworkable conditions on recovery. Unless the Secretary's decision is based on a violation of "unambiguous" requirements or a showing of "bad faith," the court below would disallow recovery of misspent Title I funds whenever the grantee can demonstrate that it complied "substantially" with "a reasonable interpretation of the law" (Pet. App. 12a).[21] These restrictions on the right of recoupment not only would severely limit the ability of the Secretary to enforce grant requirements, but also would send a clear signal to grantees that strict adherence to federal grant requirements is no longer necessary.

At present, if a grant recipient is uncertain about the meaning of statutory or regulatory limitations on the expenditure of federal funds, it has every incentive to seek an authoritative administrative inter-

[21] The court of appeals' error is attributable in part to its false characterization of the recovery of grant funds as a "penalty" on the grantee and on its concern with "the fairness of imposing sanctions" on respondent. Pet. App. 16a, 9a. Grant-in-aid agreements, however, are "much in the nature of a contract." *Pennhurst State School*, 451 U.S. at 17. Accordingly, in a recoupment action, the Secretary merely attempts to recover federal monies that were not spent in accordance with the federal statute and regulations with which the state undertook to comply; the remedy is compensatory, not punitive. Congress has provided other remedies for those who knowingly obtain money from the government for unauthorized purposes. See, *e.g.*, 31 U.S.C. 3729; 18 U.S.C. 286, 287.

pretation of those limitations. Indeed, states regularly consult with the Secretary to determine the correct interpretation of Title I regulations. Cf. *Heckler* v. *Community Health Services of Crawford County, Inc.*, No. 83-56 (May 21, 1984), slip op. 12-13. In contrast, the court's decision invites grantees to adopt their own relaxed interpretations of federal expenditure restrictions and to resist audit exceptions whenever the grant requirement alleged to have been violated is ambiguous in the slightest way.[22] Such a result is flatly inconsistent with this Court's recent admonition that "[p]rotection of the public fisc requires that those who seek public funds act with scrupulous regard for the requirements of law; [a recipient of such funds can] expect no less than to be held to the most demanding standards in its quest for public funds." *Heckler* v. *Community Health Services of Crawford County, Inc.*, slip op. 11.

This case presents a stark illustration of these adverse effects. The court of appeals acknowledged the clear intent of Congress that Title I funds be used only to provide supplemental services to a specific target group (educationally deprived children in low-

[22] We do not, of course, suggest that grantees are "crooks waiting for their chance to be dishonest" (Br. in Opp. 11). But grantees may be subject to community pressure to use federal funds to serve a broader or different population than that for which the federal program was designed. The court of appeals' standard would directly affect the degree of diligence with which grantees would ensure adherence to the terms and conditions attached to the receipt of federal funds. We note in this regard that, although Title I involves only state grantees and local school district sub-grantees, the principles of this case apply equally to any federal grantee, public or private.

income areas), and it agreed that the State had in fact violated that intent during FY 1974. Nonetheless, because the court concluded that the anti-supplanting requirement was not "unambiguous," it upheld the expenditure of $338,034 of Title I funds that supplanted state and local funds that otherwise would have been used for eligible children. Congressional intent to provide supplemental services for the educationally deprived children in low-income areas in these LEAs therefore was defeated, and the real beneficiaries of the program were instead the non-Title I children who took advantage of the state and local funds that would otherwise have been spent on the Title I children.

II. THE COURT OF APPEALS ERRED IN FINDING AMBIGUITY IN THE TITLE I STATUTE AND REGULATIONS AND IN CONCLUDING THAT THE STATE'S INTERPRETATION OF THE ANTI-SUPPLANTING REQUIREMENTS WAS REASONABLE

The error inhering in the court of appeals' standard of review was compounded by its unwarranted conclusion that "[w]here * * * a determination of whether Title I funds supplant or supplement State and local funds depends upon whether the focus is on the district or the pupil, the statute and regulations cannot be said to be unambiguous" (Pet. App. 15a). This conclusion contemplates an exceedingly low standard of reasonableness. It ignores explicit language in the Title I statute, regulations, and legislative history. It also seriously undermines a statutory and regulatory requirement critical to the proper operation of the Title I program.

The Secretary's focus on the level of state and local funds spent for the particular *children* participating

in the Title I program is expressly required by statute. Under 20 U.S.C. (1976 ed.) 241e(a)(3)(B) (emphasis added), an LEA could receive a Title I grant only if the funds were to be used:

> to supplement and, to the extent practical, increase the level of funds that would, in the absence of such Federal funds, be made available from non-Federal sources *for the education of pupils participating in programs and projects assisted under this subchapter*, and * * * in no case, * * * to supplant such funds from non-Federal sources.

This statutory provision could hardly be more explicit in stating that Title I funds must be used to supplement, and not supplant, the state and local funds that would otherwise be expended for the specific "*pupils* participating in" Title I programs. Plainly, Title I children "are not * * * to receive less than they would otherwise be entitled to receive under *any* State or local program." *Alexander* v. *Califano*, 432 F. Supp. at 1189 (emphasis in original);[22] see also *Indiana* v. *Bell*, 728 F.2d 938, 941 (7th Cir. 1984) (emphasis added) ("Title I funds could not be used to replace state and local funds that would have been spent on Title I *children* had there been no Title I money.").

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[22] The court of appeals' opinion suggests that the supplanting prohibition was applied properly in *Alexander* (Pet. App. 12a n.11). However, the present case is quite similar to the situation in *Alexander*; in both cases the total amount of state or local funds available to each LEA remained the same as it would have been had Title I funds not been available. See 432 F. Supp. at 1187. However, a supplanting violation occurred in the *Alexander* case, precisely as in this case, because Title I funds were used to supplant state or local funds that would have been expended on eligible Title I children in the absence of the Title I program. See 432 F. Supp. at 1187-1190.

The Title I regulations in effect in 1974 further emphasized what was already plain on the face of the statute: that the *children* participating in the Title I programs must receive services from state and local funds as if there were no Title I program. The regulations required that "[e]ach application for a grant under title I • • • shall contain an assurance • • • that neither the project area nor the *educationally deprived children* residing therein will • • • be penalized in the application of State and local funds because of such a use of funds under Title I. • • • Federal funds • • • will be used to supplement • • • the level of State and local funds that would, in the absence of such Federal funds, be made available for the *education of pupils participating in that* [*Title I*] *project* [and] • • • will not be used to supplant State and local funds available for the *education of such pupils*." 45 C.F.R. 116.17(h), (1) and (2) (1974) (emphasis added).[24]

The legislative history of the supplanting prohibition is equally explicit. When Congress added that provision in 1970, it explained (S. Rep. 91-634, *supra*, at 14) (emphasis added)):

> Under present law there is no specific prohibition against supplanting State and local funds even though supplanting would be inconsistent with the theory of title I. Title I funds are intended to be supplementary to the education program generally offered by the States and

[24] The EAB correctly concluded that "the statutory and regulatory provisions are sufficiently clear in their emphasis on the expenditure of funds for pupils—not LEA's, schools or grade levels—to sustain the • • • Secretary's position." Pet. App. 24a. In fact, the EAB found the regulation on this point to be "clear, even to the point of repetition." Pet. App. 25a.

> local educational agencies. The amendment made by section 109 would make clear that supplanting is prohibited and that State and local funds will be used to provide services for title I *children* which are at least comparable to the services provided to *children* who are not participating in title I programs.

As a subsequent House Report noted, "[t]he cornerstone of [Title I] and similar Federal aid-to-education programs is the premise that Federal aid must supplement—not supplant—State and local expenditures. The historic intent is that Federal dollars must represent an additional effort *for the target children*" (H.R. Rep. 95-1137, *supra*, at 139 (emphasis added)).

Despite these clear pronouncements in the Title I statute, regulations, and legislative history, the court of appeals concluded that there was an ambiguity with respect to whether the anti-supplanting provision applied to the services provided to the *children* participating in the Title I program, rather than requiring simply that the level of state and local funding of the LEA, schools, or grade levels remain constant. This conclusion is simply unsupportable.[25] The

[25] If the supplanting prohibition applied only at the LEA level, as alleged by respondent, there would have been no need to have both the supplanting prohibition and a separate maintenance of effort requirement. See 20 U.S.C. (1976 ed.) 241g(c)(2); 45 C.F.R. 116.45 (1974). Under the maintenance of effort requirement, each LEA participating in the Title I program had to expend, from year to year, essentially the same total or per-pupil amount of state and local funds for free public education as it had the year before. In light of this requirement, which was included as part of the original Title I legislation enacted in 1965 (Pub. L. No. 89-10, § 207(c)(2), 79 Stat. 32-33), the enactment in 1970 of a supplanting prohibition that applied only at the LEA level would

court reached its conclusion without stating what particular language in the statute or regulations it considered to be ambiguous. Indeed, the court's opinion contains no analysis at all of the statutory or regulatory language, or of the relevant legislative history. See Pet. App. 15a.

The record here also shows that, even if there was some possible ambiguity in the statute and regulations, respondent was well aware of the Secretary's interpretation that controlled its expenditure of the grant funds. In the standard grant application completed for FY 1974 by each of the LEAs that operated the challenged readiness programs, there was a question asking the LEA how it would "organize the program to assure that *children* participating in the component activity will receive this Title I service in addition to services to which they are ordinarily

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have been redundant. The supplanting prohibition was necessary, however, to ensure that an LEA would not, as the result of the availability of Title I funds, shift state and local funds originally expended for the benefit of Title I children to programs for non-Title I children, while maintaining the same total level of expenditures of state and local funds.

Similarly, if the supplanting prohibition applied only at the school level, as also alleged by respondent, there would have been no need to have both the supplanting prohibition and a separate comparability requirement. See 20 U.S.C. (1976 ed.) 241e(a)(3)(C); 45 C.F.R. 116.26 (1974). The comparability requirement was designed specifically to ensure that state and local funds were not diverted from Title I schools to non-Title I schools once Title I funds become available. Therefore, under the Title I regulations, an LEA has to demonstrate that each Title I school receives its fair share of services from state and local funds. See 45 C.F.R. 116.26 (1974). Again, however, the supplanting prohibition is necessary to ensure that state and local funds are not shifted from Title I children to non-Title I children within the Title I schools.

entitled from state and local school funds" (Pet. App. 27a (emphasis added)). As the EAB stated, "[h]ad the LEA's given the assurance requested and adhered to it, the SEA would have been protected." *Ibid.*

In reversing the Secretary's decision, and in finding reasonable respondent's use of Title I funds to replace state and local funds that otherwise would have been expended on Title I children, the court of appeals has allowed respondent to defeat the basic purpose of the Title I program. To the extent of the misused funds (see note #6, supra), the target population of educationally deprived children in low-income areas did not receive supplemental assistance; rather, they received the same level of services they would have received without Title I funds, although these services were financed from federal rather than state and local funds. The real beneficiaries in these LEAs were the non-Title I students. As the EAB found, "by maintaining State and local funds at the grade level while Title I paid for instructional costs of the readiness program, the SEA and the LEA's assured that additional State and local funds were devoted to non-Title I pupils—funds which in the absence of Title I would have paid for the instruction of the educationally deprived children." Pet. App. 24a. Such a use of Title I funds directly violates the mandate of Congress that the funds be used to provide supplemental educational services to educationally deprived children, and not be diverted "to meeting other needs of school systems, however pressing these other needs may be." S. Rep. 91-634, *supra*, at 10.

This case thus does not involve a mere "technical violation of the [grant] agreement" (*Bell* v. *New Jersey*, slip op. 2 (White, J., concurring)), and re-

spondent is incorrect in suggesting (Br. in Opp. 7-9) that it was in "substantial compliance" with the governing statutory and regulatory requirements. The principle that Title I funds are to be spent solely for the benefit of the targeted children lies at the very heart of the Title I program. Accordingly, the supplanting prohibition is an essential part of the statutory scheme, and its violation negates substantial compliance. Cf. *Bonwit Teller & Co.* v. *United States*, 283 U.S. 258, 264-265 (1931); *Grannis* v. *Ordean*, 234 U.S. 385 (1914); *Mutual Life Ins. Co.* v. *Phinney*, 178 U.S. 327, 337 (1900).[26] Conse-

[26] The accepted meaning of the term "substantial compliance" refers to whether compliance has been achieved with "the essential requirements" of the statute (*Wentworth* v. *Medellin*, 529 S.W.2d 125, 128 (Tex. Civ. App. 1975)), not to the clarity (or lack of clarity) of the statutory provision in question. See, *e.g.*, *City of Leneza* v. *City of Olathe*, 233 Kan. 159, 164, 660 P.2d 1368, 1373 (1983) (citation omitted) (" 'Substantial compliance' * * * refers to 'compliance in respect to the essential matters necessary to assure every reasonable objective of the statute.' "); *In re Santore*, 28 Wash. App. 319, 327, 623 P.2d 702, 707-708 (1981) ("Substantial compliance has been defined as actual compliance in respect to the substance essential to every reasonable objective of the statute."); *Houman* v. *Mayor & Council*, 155 N.J. Super. 129, 169, 382 A.2d 413, 434 (1977) (citation omitted) (" 'Substantial compliance' * * * occurs whenever * * * partial compliance has fully attained the objective of the statute."); *Smith* v. *State*, 364 So. 2d 1, 9 (Ala. Crim. App. 1978) (citations omitted) (Substantial compliance means "compliance in respect to the substance essential to every reasonable objective of the statute [where] * * * the purpose of the statute is shown to have been served."); *Dorignac* v. *Louisiana State Racing Commission*, 436 So. 2d 667, 669 (La. Ct. App. 1983) (Substantial compliance occurs where "the statute has been followed sufficiently so as to carry out the intent for which it was adopted.").

quently, the State's readiness programs cannot be considered to have been in compliance with any reasonable interpretation of the Title I statute or regulations, and the court of appeals erred in denying recoupment of the misspent funds.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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AMICUS CURIAE

BRIEF

No. 83-1795

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1984

T.H. BELL, SECRETARY OF EDUCATION, *PETITIONER*

v.

KENTUCKY DEPARTMENT OF EDUCATION,
RESPONDENT

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF AMICI CURIAE OF THE STATES OF TEXAS, IOWA, MARYLAND, NEVADA AND NEBRASKA, THE DEPARTMENTS OF EDUCATION OF CALIFORNIA, COLORADO, VERMONT AND WEST VIRGINIA, AND THE NATIONAL ASSOCIATION OF STATE BOARDS OF EDUCATION

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The Amici Curiae, by their respective legal counsel, submit this brief in support of the positions taken by Respondent Kentucky Department of Education and urge the Court to affirm the general principles set forth by the United States Court of Appeals for the Sixth Circuit.

INTEREST OF AMICI

Each of the *Amici Curiae* is acutely interested in the Court's disposition of this case.

All of the States joining in this brief have participated in the Title I program and are participating in numerous other federal grant programs.

Texas, for example, currently has eight separate audit appeals in progress totaling $2.4 million. Other audits are currently at the draft stage. California has seven Title I audits totaling approximately $33 million currently on appeal within the Department of Education. At least Texas' experience is that the audit demands are grossly overstated and that the political climate at the Department of Education, which is one of virtually total submission to the Inspector General, precludes any reasonable settlement of the claims. Recurrently, the Department adopts litigative positions at odds to the manner in which it actually funded the programs. The interest of Texas is more fully set forth in the history of the only Texas audit which has been considered by the Education Appeal Board. Amici App. That history illustrates the desparate need for this Court to act, to the full extent possible in light of the issues at hand, to curb the unconscionable abuses which are commonplace in the audit process.

With respect to Maryland, the Secretary has ordered a refund of $10,875,333 in Title I funds allegedly misspent during fiscal years 1975 through and including 1978. The focus of Maryland's dispute with the Secretary is the meaning of the terms "comparability" and "supplant" in the Title I regulations. *See* 34 C.F.R. Part 200. Maryland's appeal of the Secretary's order is currently pending before the Education Appeal Board of the Department of Education.

The National Association of State Boards of Education represents the State boards of education in 46 States and five United States Territories in the boards' effort to promote quality education and strengthen the lay control of American public education.

Amici have no interest in the issue of whether the facts of this case bring it under the rule of *contra preferentum*, that is, whether Kentucky actually relied upon a reasonable construction of an ambiguous regulation. We are aware of no other audits presenting the identical factual situation. Our interest is limited to the general standards applicable to audit recoveries.

RESTATEMENT OF ISSUES

Should a grant be treated as a contract only when it is to the grantee's detriment; specifically, can the Secretary of Education recover for breach of an ambiguous grant provision based upon his current interpretation thereof, where the grantee was not on notice of the interpretation at the time the grant contract was executed or fulfilled and relied upon its own reasonable contruction of the ambiguous provision; or, in the narrow context of retroactive recoupments of grant funds, is the general contract doctrine of *contra preferentum* applicable?

Did Kentucky actually rely upon a reasonable interpretation of an ambiguous grant provision? (not addressed by these *Amici*)

Is substantial compliance the appropriate standard for audit recoveries?

SUMMARY OF ARGUMENT

The purpose of Title I was to provide "financial assistance to local educational agencies" to support supplementary programs for educationally deprived children. 20 U.S.C. §241a (repealed). Among the subgrantees were the poorest school districts of the nation. Twenty years after the enactment of Title I and many years after funds were expended pursuant thereto, the Department of Education pursues claims against grantees and, derivatively, subgrantees, which if paid would palpably harm the education of all children in the targeted school districts and states. *Amici* agree that the audit power is necessary to promote compliance with federal objectives; however, the possibly devastating consequences of a large audit claim bolster well established rules of contract and constitutional law which require such claims to be based upon clear and substantial violations of grant requirments.

The rule of *contra preferentum*, the construction of contractual ambiguities against their author, is fully applicable to the United States. *United States v. Seckinger*, 397 U.S. 203 (1970). While there is no doubt that Petitioner has the power to prospectively interpret and define the scope of grant requirements and that his actions in such regard are entitled to deference from the judiciary, these principles simply are inapplicable to retroactive audit claims. Grants are generally viewed as contracts, *Pennhurst State School & Hospital v. Halderman*, 451 U.S. 1, 17 (1981); the distinctions between these contracts and ones of procurement do not mitigate but rather strongly reinforce the application of the rule of *contra preferentum* in this limited context.

No case of this Court has ever applied a deference concept in such an egregiously unfair manner as that sought by Petitioner. Petitioner's position boils down to a request for deference to retroactive interpretations made by federal auditors, whose every incentive is to disagree with a grantee's approach in order to produce large claims, and who have at times candidly admitted that their interpretations "have no basis in the regulations or other directives." Amici App. pp. 2-3, Part F; p. 10. Deference in this context is particularly inappropriate due to the woeful job done by Petitioner's predecessors in office in unambiguously explaining grant requirements. H. Rep. No. 95-1137, 95th Cong., 2nd Sess. 49; 1978 U.S. Code Cong. & Admin. News 4971, 5011, 5019.

Since the authority for Title I regulations rests with the Spending Power, deference to the administrative construction of ambiguous provisions in this context would eliminate the voluntary and informed consent which was essential to the validity of the regulations in the first place. *Pennhurst State School & Hospital v. Halderman, supra* at 17. Thus the source of federal power in this case perforce requires the application of the rule of *contra preferentum* in this context.

While this case only peripherally involves the doctrine of substantial compliance, that standard is so clearly applicable to retroactive audit claims that this Court should so note. The Department of Education's abuse of grantees through the audit process must be halted; a declaration of the applicability of a

substantial compliance standard, which the Department has equated with a "rule of reasonableness" in refusing to subscribe to same, would certainly promote this end. Amici App. pp. 6-7, Part M. The standard is mandated by the statutory language relied upon in *Bell v. New Jersey and Pennsylvania*, ____U.S.____, 103 S.Ct. 2187 (1983), by the current language of 20 U.S.C. §1234a, and by fundamental fairness.

If, in fact, Kentucky relied upon a reasonable interpretation of an ambiguous regulation, this case should be affirmed. If it is concluded that Kentucky did not, the case should be reversed solely on that basis and the general standards relied upon below affirmed.

ARGUMENT

I. Today's children should not be required to suffer from past ambiguities of the Department of Education.

A. General Principles

Disappointingly, the executive branch now implores this Court, contrary to basic principles of fairness and long established rules of law, to enter the "world of grantor kings and grantee serfs"[1] and strike a devastating blow for the king to the ultimate detriment of innocent children. Unfortunately, the few audit cases brought to this Court thus far have not demonstrated the overreaching which has often characterized the audit process. However, egregious as well as fair audits will be controlled by the Court's decision herein. Reversal of the sound principles relied upon below would have far reaching effects; grantees would be mercilessly subject to the "political and bureaucratic pressures"[2] which have transformed a system created to *prevent* fraud, waste, and abuse into a implement of waste and abuse.

One crucial misconception which underlays Petitioner's arguments is that audit based recoupments are not penal since

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1. Rights and Remedies Under Federal Grants, Richard B. Cappalli (Wash. D.C. Bureau of National Affairs, Inc. 1979), p. 359. (hereinafter "Cappalli").

2. Cappalli, *supra* at 348.

they are "only after the fact adjustments of accounts,"[3] and since 75% of the money recouped may be granted back to the auditee.[4] Federal programs are supplementary in nature, ergo the substantive dispute at issue here. Audit recoveries must be paid from state and local funds otherwise available for the basic education of children; grantbacks, on the other hand may not be utilized for basic programs; they must be used "to achieve the purposes of the program under which the funds were originally granted." 20 U.S.C. §1234e(a). Thus even Chapter 1 (Title I) eligible children do not necessarily "recover" for a reduction in basic educational funding; the education of non-eligible children *always* will suffer.

Integral to the proper framework from which to view this case is the recognition that Title I was enacted in 1965 for the purpose of providing

> financial assistance to *local educational agencies* serving areas with concentrations of children from low-income families to expand and improve their educational programs by various means which contribute particularly to meeting the special educational needs of educationally deprived chilren. (emphasis added).

20 U.S.C. §241a (repealed).[5] And in Senate Report No. 146 Congress noted that

> [T]his bill has a single purpose: To improve the education of young Americans.[6]

Congress found that there was no lack of materials and techniques to assist educationally deprived children, but that "the

3. Brief of Petitioner, p. 22.

4. Brief of Peititioner, p. 23 n. 15.

5. *See generally* Cappalli, Federal Grants and Cooperative Agreements §1.08 (hereinafter "Fed. Grants"). Of course the Petitioner would have this Court ignore the intent to assist "local educational agencies" since its position herein is so grossly inconsistent with that intent. Brief of Petitioner p. 3.

6. 1965 U.S. Code Cong. & Ad. News 1446, 1448.

school districts which need them most are least able to provide the necessary financial support."[7] Thus Title I established "cooperative efforts" to enhance education,[8] efforts which were not supposed to "impact adversely on the project areas." *Commonwealth of Kentucky, Dept. of Education v. Secretary of Education*, 717 F.2d 943, 949 (6th Cir. 1983).

Against this backdrop, the various states and school districts entered a partnership with the federal government. Poor school districts across the country naively accepted the federal money and expended it on supplemental programs without any warning that this money, once spent, might be extracted from a district's basic program ten years hence due to an audit exception. It is pure sophistry for Petitioner to suggest that audit recoveries are not penal; they simply do not return the parties to the position in which they would have been had the federal money not been accepted. Rather, audit recoveries, cause a district to *lose* money through participation in federal programs.

> The paradox is, of course, that the grantor has ended up punishing the very persons it sought to aid through the federal standards and their enforcement.[9]

The school children are obviously innocent of any wrongdoing. *See Weber v. Aetna Casualty & Surety Co.*, 406 U.S. 164, 175 (1972). The fact that federal money was concentrated in poor school districts aggravates the inequities.

While these considerations are not sufficient to support an argument that funds may never be recovered, the spectre of the federal government enticing states and local school districts into "cooperative efforts" only to later penalize them for their participation is such that audit recoveries should be allowed only in cases of clear violations. The real consequences of audit recoveries certainly should mitigate against their wholesale use.

7. *Id.* at 1450.

8. *Id.* at 1458.

9. Cappalli, *supra* at 86

B. The rule of *contra preferentum* is applicable to retroactive recoupment claims.

Petitioner argues that the federal courts should defer to a retroactive administrative construction of an ambiguous statute or regulation and permit thereby the penal recovery of funds from an innocent grantee. This position is inconsistent with the intent of federal grant programs, ignores the body of law most in point, and is grossly unfair in light of the miserable job the executive branch has done in providing clear guidance to grantees.

The Court of Appeals grounded its approach on basic considerations of fairness coupled with its understanding of the constitutional premises underlying this Court's decision in *Pennhurst State School & Hospital v. Halderman*, 451 U.S. 1 (1981). While the Court of Appeals was clearly correct on both points, there is a long standing rule of contract law which mandates the result reached. As noted in *Pennhurst*, *supra* at 17, a grant-in-aid agreement is "much in the nature of a contract."[10] *See also Lau v. Nichols*, 414 U.S. 563 (1974).

As long ago as 1869, this Court applied the rule of *contra preferentum* to federal contracts. In *Garrison v. United States*, 19 L.Ed. 277 (1869), a contract for the purchase of guns was ambiguous insofar as price was concerned. Holding that Mr. Garrison was entitled to $27 per gun as opposed to the $20 figure sought by the federal government, the Court stated:

> [The contract's] doubtful expression should, therefore, according to a well known rule be construed most strongly against the party who uses the language.

Id. at 278. And in *United States v. Seckinger*, 397 U.S. 203 (1970), this Court held that "a contract should be construed most strongly against the drafter, which in this case was the United States." *Accord, Department of Natural Resources & Conservation of State of Montana v. United States*, 1 Cl. Ct.

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10. The Petitioner so concedes. Brief of Petitioner p. 30, n. 21. Indeed, Petitioner relied strongly on the contract theory in its brief to this Court in *Bell v. New Jersey and Pennsylvania*, ____U.S.____, 103 S. Ct. 2187 (1983). Brief of Petitioner, No. 81-2125, p. 17.

727, 737 (U.S. Cl. Ct. 1983); *Bituminous Casualty Corp. v. Lynn*, 503 F.2d 636 (6th Cir. 1974); *H & M Moving, Inc. v. United States*, 449 F.2d 660 (U.S. Cl. Ct. 1974); *Instruments for Industry, Inc. v. United States*, 496 F.2d 1157 (2nd Cir. 1974); *Corbetta Construction Co. v. United States*, 461 F.2d 1330 (U.S. Cl. Ct. 1972); *Max Drill v. United States*, 427 F.2d 1233 (U.S. Cl. Ct. 1970).

The court in *H & M Moving, Inc. v. United States, supra*, at 671, explained:

> This oft-repeated and much-applied rule serves important purposes. It puts the risk of ambiguity, lack of clarity, and absence of proper warning on the drafting party which could have forestalled the controversy; it pushes the drafters toward improving contractual forms, and it saves contractors from hidden traps not of their own making.

In *Corbetta Construction Co. v. U.S.*, *supra* at 1336, the court made the basic observation that

> A government contractor cannot properly be required to exercise clairvoyance in determining its contractual responsibilities.

A different rule should not be applicable in the context of a grant contract. The case law certainly does not support such a distinction. For example, *Department of Natural Resources, Etc. v. United States, supra*, involved a federal assistance program. 16 U.S.C. §1002, *et. seq.* And in *Commonwealth of Kentucky, Department of Human Resources v. Donovan*, 704 F.2d 288 (6th Cir. 1983), relied upon by Petitioner, the court noted, citing *Pennhurst*, that "the Secretary will be bound by fair notions of contract law." *Id.* at 299 n. 17.

Nor is there any logic to support a refusal to apply this doctrine to retrospective audit claims under grant contracts; in fact, all differences between grants and procurement contracts buttress the application of the doctrine here. There is no profit motive at issue, participation in federal grant programs is motivated by a desire to serve one's constituents. Since most

grantees are governmental bodies, there is a presumption of regularity which attaches to their conduct. *Bishop v. Wood*, 426 U.S. 341, 350 (1976); *Chamberlain v. Wichita Falls I.S.D.*, 539 F.2d 566 (5th Cir. 1976). Grant contracts are supposedly creatures of cooperation and are exclusively contracts of adhesion; no negotiation is involved which may provide a vehicle for clearing up ambiguities. The government is the claimant in this circumstance, not the Respondent; it thus would seem even more appropriate to require that sanctions be based on clear violations. The real parties harmed by the federal government's failure to provide unambiguous requirements and any attendant lack of "clairvoyance" on the part of grantees are school children, not a private corporation. Furthermore, if the purpose of federal grants under Title I was and is to provide "financial assistance to local educational agencies" it makes no sense whatsoever to apply more prejudicial rules to retroactive claims based upon grant contracts than those applicable to procurement contracts where there is no purpose of assisting the contractor. Finally, since the rule is apparently applicable to contracts let by a grantee, refusal to apply the doctrine here without corresponding application to contractors of grantees would cause a grantee to be liable to Petitioner for damages it could not recoup from the responsible party.

C. The Spending Power basis of the regulations at issue requires the application of the doctrine of *contra preferentum* to retroactive audits.

The legitimacy of imposition of regulations through the exercise of power under the Spending Power

> rests on whether the State voluntarily and knowingly accepts the terms of the 'contract.' (citation omitted) There can, of course, be no knowing acceptance if a State is unaware of the conditions or *is unable to ascertain what is expected of it.* Accordingly, if Congress intends to impose a condition on the grant of federal moneys, it must do so unambiguously. (emphasis added)

Pennhurst State School & Hospital v. Halderman, supra at 17.

This "rule of statutory construction," *Id.* at 24, is nothing more than a constitutional pronouncement of the *contra preferentum* rule of contract law. This case is squarely within the holding of *Pennhurst*. The issue is not one of remedy for an acknowledged violation, *see Bell v. New Jersey and Pennsylvania, supra* at 2197 n. 17; rather, it is whether the State was on adequate notice of "what (was) expected of it" substantively and thus whether it agreed to the restriction at issue. Plainly, if the statutes and regulations were not clear enough to support a finding that the State should have known that its conduct was violative thereof, the voluntary assent feature is absent and the restriction may not be supported under the Spending Power. *See generally*, Fed. Grants §10.01, *et. seq.*

This is precisely what this Court alluded to in another seminal Spending Power case, *Steward Machine Co. v. Davis*, 301 U. S. 548, 594 (1937).

> In the event that some particular condition shall be found too uncertain to be capable of enforcement, it may be severed from the others, and what is left will still be valid.

Accordingly, the very basis of federal authority to regulate under the Spending Power compels observance of the *contra preferentum* rule in this context. It should be noted that this case does not involve an extension of *Pennhurst*, it merely calls for the application of *Pennhurst* to a very narrow field, retroactive audit claims. The situation here is somewhat different from *Pennhurst* since that case involved the prospective enforcement of the law. Were the Secretary arguing for deference to an interpretation for prospective purposes, *Pennhurst* would require the opposite result from that in the instant case. In the prospective respect, the interpretation would provide the clear notice required under *Pennhurst*; such a case would be governed by questions of the Secretary's statutory authority, not Spending Power considerations.

Further, a review of the actual circumstances in which this Court's ruling will be applied renders the position proferred by Petitioner even less acceptable. The need for fairness in the

"cooperative efforts" of federal grants is self-evident.[11] It is beyond doubt that the Department of Education and the executive branch as a whole have poorly explicated grant requirements. On the general level, it has been concluded that federal grant regulations are "indecipherable" and that "most of the alleged illegalities will stem from unclear federal policies or a confusing backdrop of facts."[12] More forceful and with specific reference to Title I and Petitioner's predecessors in office is the study prepared for Congress by the National Institute of Education, which formed the basis for the 1978 amendments to Title I.

> The Committee has found the quality of the research by NIE to be excellent and has consequently relied upon these reports in formulating amendments to Title I.[13]
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> . . .
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> Most seriously, NIE concluded, the failure of Title I's legal framework to provide clear guidance has in some cases led to State practices that *may* not be in compliance.[14] (emphasis added)
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> . . .

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11. The Petitioner's urging of this Court to pay no heed to the "amorphous" concept of "fairness" is surprising to those who have been involved in the audit process only for its candor. Reply Memorandum for the Petitioner, p. 2. On a minor level, this Court may thus view first hand a reversal of position by the Secretary for he argued in *Bell v. New Jersey and Pennsylvania, supra*, that "the overarching principle of *Pennhurst* is the concept of fairness" and proceeded to rely upon his view of what was "fair." Brief of Petitioner, No. 81-2125, p. 42. Petitioner's reversal of position in this regard is tantamount to a concession that the position urged in this case is unfair. It is due to the absence of either fairness or consistency in the executive branch that the decision in this case is so vitally important.

12. Fed. Grants, *supra* at §6.01; Capalli, *supra* at 23,217.

13. H. Rep. No. 95-1137, 95th Cong., 2nd Sess. 49; 1978 U.S. Code Cong. & Admin. News 4971, 4975. These studies are also relied upon by Petitioners. Brief of Petitioner, p. 3 n. 2.

14. *Id.* at 5011.

> The NIE provided evidence that OE is implementing administrative requirements in a manner which is neither clear nor consistent, and that this inconsistency is confusing States and local educational agencies about their obligations. In particular, NIE found that OE does not apply consistent standards in identifying violations of the "supplement not supplant" requirements. . . .
>
> The NIE found that the law and regulations are not written clearly enough to be understood by those who implement the program.[15]

Accordingly, Congress amended Title I "to simplify Federal education programs to make their requirements more understandable.[16] This was not enough; in 1981 Congress again amended Title I in part "to eliminate . . . undue Federal interference in the operation of State and local educational agencies" and to "simplify administrative and program requirements."[17]

One may ask: where is the voluntary acceptance of conditions which NIE concluded could not be understood? How is a State "to ascertain what is expected of it" when NIE, in retrospect, was unsure of whether certain practices were in compliance, and when the federal executive is "neither clear nor consistent?" Congress has twice attempted to clear up the morass created by Petitioner's predecessors in office; now Petitioner seeks to enlist this Court in an effort to visit the sins of the federal bureaucrats on the heads of today's children. That he seeks to do so through arguing for deference to interpretions which the auditors themselves admit "have no basis in the regulations

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15. *Id.* at 5019

16. *Id.* at 4971.

17. S. Rep. No. 97-139, 97th Congress, 1st Sess. 895 (1981); 1981 U.S. Code Cong. & Admin. News 919. *See* 20 U.S.C. §3801. Contrary to the suggestion of Petitioner, Brief of Petitioner p. 2 n. 1, subsequent legislation is relevant to the issues at hand. In 20 U.S.C. §3801, *et seq.* Congress dealt a death knell to many of the regulatory sources of the audits which will be controlled by this decision; for example, comparability.

or other directives"[18] makes it no mystery why this Court is asked to avoid any inquiry into fairness. The rule of *contra preferentum* could hardly find more suitable lodging.

The current situation is even less heartening. The present administration's "deregulation" policy has resulted in regulations that do little other than parrot or paraphrase the statutes, ostensibly out of fear of expanding upon the law. *E.g. Compare* 20 U.S.C. §3861(b) with 34 C.F.R. 298.13 (supplanting); *Compare* 20 U.S.C. §3805(b) with 34 C.F.R. 200.49 - 200.53. The non-regulatory guidelines issued are only slightly more informative since the questions are prepared by the Department and are usually very general in nature. Finally, the grantee is frequently not on notice of the need to seek clarification; ambiguous provisions usually mean something to everyone, the problem is that the perceived meanings are not the same. *See H & M Moving, Inc. v. United States, supra* at 671 (noting distinction between patent and latent ambiguities and holding duty to inquire applicable only to former).

The suggestions of Petitioner that grantees can "seek clarification" of ambiguous regulations[19] is comical, if in a Kafkaesque sense. Past and present experience is that federal officials do not want to take the responsiblity of answering questions, much less answering them in writing. In reality the programs are far too massive for Petitioner to respond to the myriad of issues which may arise. There are 1371 Chapter I programs, 1050 Chapter 2 programs, 943 vocational education programs, and 1061 special education programs in Texas alone. In the real

18. Letter of Regional Audit Director, *Amici* App. p. 10. It is important to realize whose interpretation Petitioner is seeking to apply. It is the auditors', who come along after the fact, reach their own interpretations of program requirements, and write grossly excessive audit demands which fuel the fires of the "fraud, waste and abuse" hysteria. Time and again the auditors take positions at odds with those under which the program officials administered the grants. These officials are often not around at that point or are either powerless or too intimidated to force the auditors to back off. The experience of Texas in attempting to secure the testimony of one such program official is briefly set forth in the Appendix.

19. Brief of Petitioner, pp. 13, 27 n. 19.

world where grantees live, interpretative decisions *must* be made at local and state levels. This is entirely consistent with the grant concept of "cooperative agreements." What is inconsistent therewith is a situation where a grantee honestly misunderstands the ambiguities of the federal government and then is penalized whenever an auditor, whose mission it is to produce large claims, in either good or bad faith disagrees with a reasonable interpretation of program requirements made by the grantee.

In fact, Petitioner seeks even more. The argument is that the *current* interpretation should receive deference, that no injustice is created by retroactive application thereof. Let us assume that the executive had a duty to respond to inquiry within a specified time, which would be essential for the suggestions of Petitioner to even approach reality. The effect of such a response in the face of disagreement by the auditor and, like a domino, a subsequent administration would at best be to cast the grantee into the difficult area of governmental estoppel. *See Heckler v. Community Health Services of Crawford*, ____U.S.____, 104 S.Ct. 2218 (1984).[20]

D. This case is not controlled by any precedent calling for deferral to an administrative interpretation.

Nor do the authorities cited by Petitioner support the unjust position proferred. It is critical to bear in mind that the circumstance at issue is an executed and fulfilled grant agreement or contract. There is no doubt that the Secretary of Education has broad authority to adopt prospective interpretations of federal rules and statutes and that this Court should defer to his judgment whenever possible in that regard. It is in this area

20. The prospect is not illusory. In a Food and Nutrition Audit the Department of Agriculture demanded the return of funds from Texas on the basis that they had not been obligated before the deadline. The Department refused, in its audit, to abide by its own telegrammed assurance that the deadline had been extended on the grounds that the assurance was legally incorrect. Ironically, the extension was brought about by the Department's inability to perform its duties in a timely manner. It was only after Texas filed suit that the claim was abandoned, whereupon Texas took a non-suit. *State of Texas v. Block*, No. CA 3-83-2074-R, Northern District of Texas. If the court had been required by this Court to defer to the current interpretation the claim probably would not have been abandoned.

of prospective application that the deference rule is applied to federal grants and entitlements. *see Schweiker v. Gray Panthers*, 453 U.S. 34, 44 (1981); *Batterton v. Francis*, 432 U.S. 416, 425 (1977). It seems that a different result would have obtained in these cases if an auditor in the executive branch had determined that a regulation should have been interpreted differently and demanded a refund of Social Security benefits.[21]

For the most part, the cases relied upon by Petitioner for deference involve either long standing interpretations which were known and often relied upon,[22] or regulatory efforts which did not involve grants or contracts at all and the authority for which did not rest with the Spending Clause.[23] The latter were often attempts to apply the law to a dispute between private parties, not backbiting of partners in "cooperative efforts." Others involved purely prospective regulations.[24] *United States v. Morton*, ___U.S.___, 104 S.Ct. 2769 (1984), involved a regulation formalizing an interpretation which had led to earlier action by the federal agency. Quite different would be a situation where the funds had been paid and a new interpretation brought forth in an attempt to recover such funds. Moreover, *Morton* involved an issue of the duties of the federal agency itself, not the duties of another party such as a grantee contractor.

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21. Even that would, in a very real sense, be more just than what is attempted here, for the benefits were presumably spent by the individuals as "general aid." Thus a refund would have come from the same pocket that the grant went into and the parties returned to the position they would have occupied had the money not been disbursed. This was the situation in other recoupment cases relied upon by Petitioner, *see e.g. United States v. Barlow*, 132 U.S. 271, 281 (1889), but is not the situation here.

22. *Zenith Radio Corp. v. United States*, 437 U.S. 443, 450 (1978); *United States v. Larionoff*, 431 U.S. 864 (1977); *Udall v. Tallman*, 380 U.S. 1, 16 (1965).

23. *FCC v. Democratic Senatorial Campaign Committee*, 454 U.S. 27, 39 (1981); *Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367, 381 (1967); *Securities Comm. v. Chenery Corp.*, 332 U.S. 194 (1947); *Unemployment Compensation Comm'r. v. Aragon*, 329 U.S. 143, 153-54 (1946); *NLRB v. Hearst Publications, Inc.*, 322 U.S. 111, 131 (1942).

24. *Chevron, U.S.A., Inc. v. National Resources Defense Council*, ___U.S.___, 104 S.Ct. 2778 (1984); *Mississippi Valley Barge Line Co. v. United States*, 292 U.S. 282, 286-287 (1934); *Industrial Holographics, Inc. v. Donovan*, 722 F.2d 1362 (7th Cir. 1983).

Nor is *Heckler v. Community Health Services of Crawford, supra*, supportive of Petitioner herein. That case involved the use of an estoppel defense to a claim based upon an admitted overfunding. "[B]y respondent's own account the expansion of its operation was achieved through unlawful access to federal funds." *Id.* at 2225. Apparently the grantee did not argue that its interpretation had been reasonable or that the regulation was ambiguous, probably because the characterization of a CETA grant "to provide training and job opportunities" as a "seed money grant" "designated for the development of new health care agencies or for expansion of services of established agencies" was strained to say the least. The Court was faced with a situation where a grantee should have known that its interpretation was unreasonable, as found by the district court. Of course recovery was proper and the holding of that case would be unaffected by the proper resolution of the instant case. In fact, it would seem that in order to "act with scrupulous regard for the requirements of law," *Id.* at 2225, a grantee must first know that those requirements are, which is the message of *Pennhurst* and the purpose of the rule of *contra preferentum*. *Heckler* would not have been a case implicating the rule, for as argued by the United States in *United States v. Secklinger, supra*, it is only applicable where both interpretations are reasonable. *H & M Moving, Inc. v. United States, supra* at 671; *Sturm v. United States*, 421 F.2d 723, 727 (U.S. Ct. Cl. 1970).

Moreover, entitlement programs such as Medicare are designed to assist individuals. Educational grants are expressly designed to assist educational agencies in fulfilling their function and hence derivatively to benefit children, thus requiring much more in program cooperation and implementation. Recovery in the former instance does not harm the program beneficiaries; in the latter the agencies and thus the children are actually penalized. This counsels for more restricted use of audit recoveries in the education area.

This Court has been cognizant that deference to administrative bodies and their *ad hoc* determinations depends upon the context. Thus in *N.L.R.B. v. Bell Aerospace*, 416 U.S. 267, 295 (1974), the Court noted that

> this is not a case in which some new liability is sought to be imposed on individuals for past actions which were taken in good faith reliance on Board pronouncements. *Nor are fines or damages involved here.* (emphasis added)

C.f. Rosado v. Wyman, 397 U.S. 397 (1969) (prospective application in grant context).

Moreover, since the Petitioner is seeking this Court's imprimatur on the process of interpreting retroactively by audit, the retroactivity cases are analogous. It will *always* be a "manifest injustice" to resolve ambiguities against grantees in audit proceedings. This process will *always* "change . . . the substantive obligations of the parties" and advance notice of the interpretations would *always* "have caused the [grantee] to order its conduct so as to render [the] litigation unnecessary." *Bradley v. Richmond School Board*, 416 U.S. 696, 721 (1974). *See Chevron Oil Co. v. Huson*, 404 U.S. 97, 107 (1972); *City of Great Falls v. U.S. Department of Labor*, 673 F.2d 1065 (9th Cir. 1982). *See generally*, Fed. Grants, *supra* at §1.11 (1984 Supp.) p. 13-15. Other federal courts have also drawn a distinction between deference prospectively and retroactively. *State of California v. Block*, 663 F.2d 855 (9th Cir. 1981); *Meade Township v. Andrus*, 695 F.2d 1006 (6th Cir. 1982); *Retail, Wholesale and Dept. Store v. N.L.R.B.*, 466 F.2d 380, 390 (D.C. Cir. 1982); *White v. Califano*, 473 F.Supp. 503 (D.W. Va. 1979).

Petitioner drew a similar distinction in *Bell v. New Jersey and Pennsylvania*, ____U.S.____, 103 S.Ct. 2187 (1983), noting that retroactive application of procedural rules

> do not transform a legal act into an illegal act or otherwise alter the legal expectations upon which a party based his prior conduct.

Brief of Petitioner, No. 81-2125, p. 39 n. 52. *See Commonwealth of Kentucky, Department of Human Resources v. Donovan, supra*,. This case *does* involve an alteration of these legal expectations.

Actually the only cases supporting Petitioner in the effort

to transform grants into one-way contracts are *Indiana v. Bell*, 728 F.2d 938 (7th Cir. 1984), and arguably *West Virginia v. Secretary of Education*, 667 F.2d 417 (4th Cir. 1981). The latter decision is unclear concerning the chronological orgin of the interpretation of "school facilities" to which deference was given. The former decision was flat wrong in some respects.[25] Neither case cites any decision calling for deference in the retroactive audit context. The only decision of this Court cited by either panel was *United States v. Larionoff, supra*, which involved a claim for additional compensation in conflict with an interpretation which had been applied and under which compensation had been paid throughout the period at issue. Neither case examined either the application of the rule of *contra preferentum* to grant contracts or the constitutional requirements for Spending Power regulations.

Further, there exist sound reasons here why "it is dangerous to defer automatically to the agency's view." *Bethlehem Steel Corp. v. United States Environmental Protection Agency*, 723 F.2d 1303, 1309 (7th Cir. 1983). The Department of Education, prodded by unaccountable auditors and political pressure, is a contestant with a direct stake in the outcome. Experience has indicated that the entire process is hardly even-handed and above political machinations. The political goals of one administration are not necessarily those of the next; is it to be the grantees who suffer from ideological shifts at the federal level? If one were attempting to attack the viability of federal programs through the back door, what better way than to have the power to reinterpret and impose audit liability?

Further,

> lack of precision and comprehensibility effectively transfer governmental power away from federal, state, and local officials and into the hands of federal and federally supervised auditors. Fear of audit exceptions leading to costly disallowances, in combination with

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25. The court ignored evidence that an overwhelming majority of children served by one of the programs were Title I eligible on the basis that the program was improperly "designed." Thus the Title I program received a windfall at the expense of the State's basic education program.

the legal insecurity bred by poorly written rules, leads inevitably to grantees developing the most legally acceptable programs and projects and not the soundest activities from the perspective of the program's goals.[9]

> 9. *See Id.* at 26: "Several other findings ... have led the Committee to believe that districts are simply not aware of the flexibility afforded them to design and operate Title I programs under the present legal framework, or else may be avoiding unfamiliar alternatives for fear of audit exceptions."[26]

Certainly the rule sought by the Petitioner would drastically aggravate the situation. In fact, an administration professing to be anti-regulatory appearing in this Court seeking such onerous regulatory power is curiously anomalous.

E. Petitioner's parade of horrors reverses reality.

Petitioner claims that the proper resolution of this case would drastically reduce audit claims due to the "rare" nature of instances in which a grantee's expenditures were not supported by a reasonable interpretation of the regulations and that this "would greatly undermine the administration of federal grant programs."[27] First, Petitioner's characterization of most audits[28] bears witness to the fact that many audits are abusive and without any redeeming effects. Requiring one to be legally entitled to a recovery does indeed have a tendency to reduce recoveries. Audits which can not withstand basic principles of contract law *should* be eliminated. It is the Department of Education, not grantees in general, which needs to adopt a

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26. Capalli, *supra* at 361-62, citing H.R. Rep. No. 95-1137, 95th Cong., 2nd Sess. 26 (1978); 1978 U.S. Code Cong. & Adm. News 4971, 4996.

27. Brief of Petitioner, p. 15.

28. In all candor he is not entirely correct. Texas acknowledges that it owes part of the 2.4 million dollars currently on appeal in eight audits. Unjustifiable mistakes have been made.

reasonable posture in order to settle audits rather than litigate them. A correct decision by this Court would not provide incentive to resist *valid* audit exceptions, unfair exceptions provide their own incentive for challenge. Nor would application of *contra preferentum* create an incentive for noncompliance with one's contractual obligation; otherwise, this Court would not have applied the rule to federal contracts.

The suggestion that what is viewed as basic fairness "would greatly undermine the administration of federal grant programs" is more significant. However, the only manner proposed by which such an effect would obtain is that grantees would not have incentive to "seek clarification." This is as ficticious as the implication that such a "clarification" process is either operative or even feasible. Grantees would practically always prefer to have the word of the grantor agency on a matter; there is no assurance that a grantee's interpretation would later be deemed reasonable by an auditor, the grantor, or the courts. To the contrary, it is the position urged by Petitioner which "would greatly undermine the administration of federal grant programs," particularly the fair administration thereof. Oppressive, in some instances selectively retaliatory audits would continue apace and increase, with continued generation of animousities on the part of grantees. So much for "cooperative efforts."

Finally, the glaring inconsistencies between Petitioner's arguments herein and those in *Bell v. New Jersey and Pennsylvania* warrant examination. In *Bell* Petitioner claimed that the audits involved "conditions ... of which they were aware prior to receipt of the funds."[29] This Court was told that:

> Needless to say, the reasonableness of a grantee's interpretation of an ambiguous regulation is a factor considered by the Secretary in determining whether to seek recoupment of wrongfully expended federal funds.[30]

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29. Brief of Petitioner, No. 81-2125, p. 39.

30. Reply Brief of Petitioner, No. 81-2125, p. 8 n. 10. To be contrasted with this statement is the Secretary's real view that it is not "appropriate" for him to insist that audit demands be reasonable. *Amici* App. pp. 6-7, part M.

Now Petitioner argues that he may ignore the reasonableness of such an interpretation, that recoveries are justified when a grantee is *not* on notice of the conditions prior to receipt of funds, and that the courts should defer thereto. It would seem that Petitioner runs afoul of the limitation on recoveries he espoused in *Bell v. New Jersey*, that is, that recoupments should be permitted "absent any showing of unfairness."[31]

There is no basis in law or policy to apply the contract theory of grants only one way. In fact, it is contrary to the very constitutional basis for grant restrictions. There is no reason why Mr. Garrison should have received the additional $7 per gun in 1869 due to ambiguity in his contract but children in the poorest of the nation's school districts be required to pay with their education for the ambiguity created by the federal executive in programs completed years ago.[32]

> It is no less good morals and good law that the Government should turn square corners in dealing with the people than that the people should turn square corners in dealing with their government.

Heckler v. Community Health Services of Crawford, supra at 2224 n. 13, citing *St. Regis Paper Co. v. United States*, 368 U.S. 208, 229 (1967) (Black, J., dissenting). The rule of *contra preferentum* should be held to apply and the federal government barred from recoveries where a grantee relied upon a reasonable interpretation of an ambiguous statute or regulation in the absence of notice that the interpretation was incorrect[33] The rule is not a "good faith" exception, although

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31. Brief of Petitioner, No. 81-2125, p. 17.

32. Presumably Petitioner's rule of deference would be applicalbe to all future audit issues. Thus courts would be required to give deference to the Interpretative Rule first issued in 44 Fed. Reg. 39404 (July 6, 1979) which purported to establish the measure of recovery for comparability audits. Under this little jewel, one Texas district is faced with a demand for nearly $10,000 for the unknowing failure to expend $95.04 in state and local money at two schools. Amici app. p. 5. *See* Cappalli, *supra* at 90-92 (concept of proportionality).

33. Contrary to the Petitioner's assertion, Brief for Petitioner, p. 24 n. 16, it is not anomalous to place the burden of demonstrating the allowability of

(footnote continued on next page)

good faith on the part of the grantee is one element thereof; rather, application of the rule would prevent the federal government from acting in bad faith.

II. Substantial compliance is the standard applicable to recoupment claims.

Petitioner argues that the standard of substantial compliance is applicable only to withholding actions and cease-and-desist orders, that strict compliance is the standard for audit recoveries. It is asserted that a more lenient standard is appropriate in the former circumstances "to avoid sudden disruptions in the Title I program," whereas "audit claims involve only after-the-fact adjustments of accounts."[34] Petitioner is clearly wrong on the law[35] and presents a factual picture befitting of Lewis Carroll.

First, in the real world, it makes absolutely no sense whatsoever to apply a more restrictive standard retroactively than prospectively. In the withholding and cease-and-desist contexts a grantee is put on notice of a violation at the time[36] and can correct the situation with no adverse consequences, which, it is

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(footnote continued from previous page)
expenditures on grantees and apply the rule of *contra preferentum*. This is the case in contract claims against the United States. What is anomalous is to place the burden on the grantee at all since it is a negative burden and since the grantee is not the one claiming damages. Moreover, application of the rule is not inconsistent with Petitioner's broad authority to specify terms of the grant contracts by regulation or otherwise; that is also the situation in all federal contract cases.

34. Brief of Petitioner, p. 22.

35. In *Bell v. New Jersey & Pennsylvania, supra* Petitioner took the inconsistent position that he could recover funds paid "for services... provided in a manner so *substantially* inconsistent with the terms of the agreement ... that the default results in a failure of consideration." (emphais added) Brief of Petitioner, No. 81-2125, p. 17. *See also Amici App.* pp. 6-7, Part M (Petitioner's counsel equates "substantial compliance" with a "rule of reasonableness.")

36. The suggestion that these powers create a "sudden disruption" is incorrect. Opportunity for a hearing is required prior to any adverse action under 20 U.S.C. §§1234b and 1234c except for suspension *pendente lite* which requires an opportunity to show cause why such action should not be taken.

submitted, essentially all grantees would do. Grantees do not want to violate the law; they only need to know what the law is. In the audit context mistakes can not be corrected. To a grantee, the audit is more harmful than a termination of the program for, as previously noted, an audit recovery does not return the grantee to the position it would have occupied had it not received the federal funds.[37] Moreover, Petitioner argues for the ridiculous situation where the executive can discover a current practice not in strict compliance, be powerless to order its cessation or withhold funds, and then recoup those funds after they are spent. Similarly, a State could be faced with audit recoveries based upon funding of subgrantees which it was powerless to prevent, for the State's withholding authority is subject to the substantial compliance standard. 20 U.S.C. §1232c(b); 20 U.S.C. §241j (1965) (repealed).

Fortunately, such an absurd result is not supported by law. In *Bell v. New Jersey and Pennsylvania, supra* at 2193, this Court based the recoupment of pre-1978 funds on the duty of the Commissioner to

> take into account the extent...to which any previous payment to each State education agency under this title...was greater or less than the amount *which should have been paid to it.* (emphasis added)

20 U.S.C. §241g(a)(1) (repealed). Thus the Court directly linked the recoupment authority to the payment authority. The Commissioner had a duty to "pay" funds to states with approved applications unless "there [had] been a failure to comply substantially with any assurance set forth in the application ...." 20 U.S.C. §241j. Plainly, a payment could not have been "greater ... than the amount which should have been paid" if that payment was mandated by law. Accordingly, the conclusion is inescapable that with respect to pre-1978 funds recoveries may be obtained only where there was a failure to comply substantially with the Title I requirements.

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37. The only exception to this would be where the federal money had merely been added to the grantee's general fund and not expended on any additional or special projects, a situation which is rare if existent at all, and which clearly would not meet any substantial compliance standard.

Furthermore, the substantial compliance standard was the *only* standard of liability of which the State was on notice[38] at least until 1978. This substantive standard of liability is central to the fiscal consequences of participation by a grantee; it is much more closely akin to the substantive compliance issues governed by *Pennhurst* than to mere procedural issues of remedy. *See Bell v. New Jersey and Pennsylvania, supra* at 2197 n. 17. Thus its application is compelled by principles underlying regulation pursuant to the Spending Power.

Nor was the standard altered by the 1978 amendments. As noted in *Bell v. New Jersey and Pennsylvania, supra* at 2196, citing the legislative history to the 1978 amendments,

> nothing in these new provisions should be interpreted as radically changing the present relationship of the Federal government to the States.... These amendments, rather, are meant merely to lay out responsibilities more clearly....

The language of 20 U.S.C. §1234a refers to "an expenditure not allowable." Once again, how can an expenditure not be "allowable," which the dictionary defines as "permissible," if it is

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38. Petitioner can not point to a single document which notified grantees that a different standard would be applicable to audits as opposed to withholding. Indeed, when the matter was first broached in Texas' comparability appeal, the Department stated:

> I don't really think that, as a practical matter, the Department of Education and the State of Texas are in a great deal of dispute about that -- what the precise test is. We wouldn't be here today if we were talking about purely technical violations, or, in fact, the state had demonstrated substantial compliance or reasonable compliance with the regulations.
>
> Unfortunately, what we have here is a situation where the state really hasn't shown that, but it has been arguing its case as if it had.

Transcript of Proceedings, Docket No. 7-(43)-78, Education Appeal Board, April 26, 1982, p. 31. Of course when the State later made such an evidentiary showing the Department reversed its position and began insisting on strict compliance. They bring this reversal of position now to this Court.

compelled by law? Surely this Court should not attribute to Congress the unjust and illogical position proposed by Petitioner.[39] There is no sound reason in policy or law to utilize a more punitive standard against school children than that applicable in other contexts. *See e.g.* 42 U.S.C. §5304(d), 5318(h) (recoveries authorized under Community Development Grants only if expenditures were for illegal activities); *Economic Opportunity Commission of Nassau Cty,. Inc. v. Weinberger*, 524 F.2d 393 (2nd Cir. 1975) (material defect in procedures standard applicable to HEW); Federal Grant Law; Mason (1982), pp. 179, 184 (an EPA grantee may waive minor, but not major, irregularities in bidding). *c.f.* Fed. Grants, *supra* at §§8.03, 8.14.

Finally, *Amici* basically agree with Petitioner that this is not a substantial compliance case, except insofar as that standard inferentially reinforces our conclusion concerning the rule of *contra preferentum*. If Kentucky should have known that its program was violative of the supplanting regulations then that violation was clearly substantial. However, we do disagree with any assertion that the concept does not incorporate a quantitative as well as qualitative aspect. *De minimus* violations will not support audit recoveries. *c.f.* Cappalli, *supra* at 221 n. 119 (discussing substantiality versus *de minimus* government actions for due process purposes). Otherwise, nearly all grantees would be subject to the political whims of the federal executive.

> Given the complexity of grant requirements, as well as their frequent ambiguity, something can usually be found lacking in the operations of even the most concientious and capable grantee.[40]

39. Nor is Petitioner's reference to H.R. 11 of any avail. Brief of Petitioners, p. 21 n. 13. In fact, the amendments approved by the House covered much more than the standard at issue. Moreover, the Conference Committee "recognize[d] that State and local educational agencies have legitimate and long-standing complaints with respect to the fairness and due process of the education auditing process," and indicated that joint hearings would be held to move to an "appropriate legislative remedy." H. Rep. No. 98-1128, 98th Congress, 2nd Sess. 54 (1984). *See also* Cong. Rec., July 25, 1984, H. 7813 *et seq.*, for legislative history in the House of Representatives.

40. Cappalli, *supra* at 18.

There is simply nothing to support a strict compliance standard in this context other than irresponsibly overzealous desires to create large audit exceptions which penalize children.

> [The substantial compliance standard] frankly recognizes that the application of vague, complex, voluminous and technical federal standards to countless instances of state and local government policy and action is tricky, imprecise business.

Fed. Grants, *supra* at § 15.26, p. 39. At least in its supervisory role this Court should note that this rule is applicable since grantees are being harrassed and their resources drained by the Petitioner's contrary, if insupportable, view.

It is vastly preferable to enforce grant conditions prospectively. *See Lau v. Nichols, supra.* It would appear that, under Petitioner's view, an auditor who found a single violation of, for example, Title VI or Public Law 94-142, could demand a return of all federal moneys expended in the program at issue. The effect would be the grant of awsome discretionary power to an executive which has proven more than capable of abuse of power.[41] Surely this Court should not ascribe to Congress an intent whereby its findings in *Lau* would have supported a recoupment of all federal funds granted to San Francisco School District or the State of California during the period of noncompliance with Title VI. There is simply no reason to be more stringent retroactively than prospectively, all good faith policy and legal considerations support the opposite approach. Substantial compliance *must* be held to be the *most* restrictive standard which may be applied retroactively.

CONCLUSION

In an era of another political tenor, this Court stated with respect to a Spending Power case that

41. A strict compliance standard would also assist in retaliatory audits. Texas' belief is that grantees which refuse to be intimidated by federal abuse and refuse to accept it as a fact of life are concentrated upon as future audit targets.

> it seems farfetched to foresee the Federal Government turning its back upon a people who had been benefited by it....

Ivanhoe Irrigation Dist. v. McCracken, 357 U.S. 275, 299 (1958). The Court should prevent such an attempt here and uphold the general principles set forth by the Court of Appeals. Since Petitioner is unable or unwilling to require the audit process to observe a "rule of reasonableness,"[42] *Amici* plead of this Court that it do so. Thus should be concluded another "unedifying example of overzealousness on the part of the Federal Government." *Grove City College v. Bell*, ____U.S.____, 104 S.Ct. 1211, 1223 (1984) (Powell, J., concurring).

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42. *Amici* App. pp. 6-7, Part M, detailing the Department's refusal to apply such a standard to audits.

APPENDIX OF THE STATE OF TEXAS

I. History of the *Appeal of the State of Texas*, Education Appeal Board, Docket No. 7-(43)-78, and related matters.

A. In 1970 Congress amended Title I to impose a "Comparability" requirement, 20 U.S.C. §241e(a)(3)(c), providing:

> State and local funds will be used in the district of such agency to provide services in project areas which, taken as a whole, are at least comparable to services being provided in areas in such district which are not receiving funds under this subchapter.

The law called for comparability reports to be filed annually commencing with July 1, 1971, but provided that the payment of funds would not be affected until the fiscal year beginning July 1, 1972.

B. On February 26, 1970, the Office of Education issued ESEA Title I Program Guide 57. The guide indicated that criteria for comparability would include student/professional staff ratios and per pupil expenditures. The guide suggested that the criteria could take into account the size of schools. In other words, large project schools could be compared only to large non-project schools due to economies of scale.

C. In 1971 OE issued its first comparability regulation. 36 Fed. Reg. 20014 (Oct. 14, 1971). The regulations were silent as to size grouping.

D. Twenty months later OE issued new regulations. 38 Fed. Reg. 17126 (June 28, 1973). These regulations indicated that size grouping was "under consideration." Comment 6. Provisions were added requiring exclusion of handicapped children who "are enrolled in separate special education classes" from the computations and expressly including "principals, consultants, librarians, and guidance and psychological personnel." The latter is the principal source of economies of scale.

E. During the 1973-74 school 128 Texas school districts prepared comparability reports which required attribution of staff and salaries to each school on a full time equivalent basis as of a particular day. The reports were required for a day prior to December 1, 1973; until the reports were prepared school district were unable to ascertain whether their services were in fact comparable under the data collection and calculations required by the regulations. The districts later in question demonstrated comparability in these reports. OE had expressly advised the State in numerous documents that it "may use this information to determine compliance." *E.g.* Memorandum of July 24, 1973, from Deputy Commissioner for School Systems. OE on numerous occasions had also indicated that districts had until December 1, 1973, to attain comparability. For example, the July 24, 1973, memorandum indicated that districts which were not comparable prior to December 1 must have their funds withheld and if they do not attain comparability prior to March 31 their application must be disapproved. *See* §116.26(b), (k) of the 1973 regulations, *supra.* The memorandum explained:

> 8. Q. For an LEA not in compliance by March 31, is its allocation for the entire year made available for reallocation to other LEAs in the State?
>
> A. No. Only that part of the allocation which is not obligated by the cutoff date of December 1 becomes available for reallocation.

Thus the State could not refuse to fund districts prior to December 1, 1973, and could not recoup funds obligated before that date. This was supported by numerous other OE documents included as Exhibits to Texas' appeal.

F. In 1975 an audit was conducted of five Texas districts. On August 11, 1975, the auditors had to write for a decision concerning whether the salary of an employee who worked only a portion of the year should be annualized, noting a conflict in the regulations. Petitioner's Ex. 11, Appeal of State of Texas.

On November 4, 1975, the Regional Audit Director wrote the central office concerning the Texas audit. He noted that they had taken "the hardest possible stand" and demanded a refund of $7.6 million dollars as urged by an OE Associate Commissioner "so that OE would be in a better position to negotiate with the SEA." He questioned the entire audit in part because:

> the comparability regulations and related guidance are not sufficiently specific in the methodology for determining comparability. In the course of our audits *we have had to make regulatory interpretations which we believe are equitable but which have no basis in the regulations or other directives.* (emphasis added)

The letter is appended to this history as Part II.

The auditors also requested a ruling concerning funds expended before December 1, 1973, since "we have been advised . . . that a noncomplying LEA is entitled to grant funds through December 1, 1973, even if comparability was not attained by March 31, 1974." Petitioner's Ex. 17, Appeal of State of Texas. Even the auditors perceived the injustice in applying rules retroactively through audits which were inconsistent with rules governing the expenditure of funds. Nevertheless, the issue was resolved against the grantee.

G. In 1976 OE issued yet another set of comparability regulations. 41 Fed. Reg. 42894 (Sept. 28, 1976). At last size grouping was authorized and in fact relied upon to justify the limit of a 5% deviation and the inclusion of principals, etc. as instructional staff. §116a 26(i)(4), Comments 5, 8.

H. On January 30, 1978, OE issued a final determination letter for $350,151 in the Texas comparability audit. Money was demanded which had been expended prior to December 1, 1973, in flat contradiction to the consistent position expressed in 1973-74. Basically, the auditors had found alleged errors in the attribution of full time equivalent instructional staff to each school and had reallocated 1/5th of a

librarian here and there, and had disagreed with several practices by the districts, relying upon interpretations which "have no basis in the regulations or other directives." The auditors decided that special education students who were served at least in part in "separate special education classes" should not be excluded because they had not *formally* been evaluated as special education students, although no OE document had alluded to such a restriction. Further, the auditors decided that districts could not take credit for instructional staff hired before December 1, 1973, to fill vacancies created by resignations existing on the day audited, although some of these vacancies existed for only a few days and were beyond the control of the district. It should be noted that the comparison of each project school to a non-project average creates a perversion regarding teacher vacancies, for a 5% vacancy rate will effect the non-project average by .05 FTE and .05 of a salary, but an individual Title I school with a vacancy will have a reduction of 1 FTE and 1 salary, thus producing a significant "technical" defect although "services as a whole" were comparable, which was the statutory language. Incidentally, the 1981 amendments expressly overrule the approach taken by the auditors and still urged by the Department. 20 U.S.C. §3807(c)(2).

I. Not surprisingly in the face of such an audit the State appealed. Nine months later the burden of demonstrating the allowability of expenditures was purportedly placed on the State by 20 U.S.C. §1234a. No discovery was permitted. Indeed, the State had to file suit in United States District Court before the Department agreed to even let an attorney talk informally to Dr. Staehle, the Department's primary comparability expert. At that conference, the Department's attorney effectively prevented any meaningful exchange of information by continuously interrupting.

J. The State's settlement offers were rejected.

K. The State presented, as noted by the Panel, "exhaustive" documentary evidence in support of its position. The bulk of the State's proof consisted of the auditor's own workpapers. The department *never* contested proof that all

schools would have been comparable under size-grouping, but argued that the 1976 regulations could not be applied retroactively. Of course the department *did* wish to apply anything which was to its benefit retroactively, including the burden of demonstration provisions and its current view that districts did not have until December 1, 1973, to come into compliance with no penalty.

L. On November 15, 1982, the Panel issued a 25 page decision detailing the evidence and reducing the claim to $43,365, basing its decision mostly on agreement with Texas' positions regarding special education students, teaching vacancies, and the right of districts to come into compliance prior to December 1, 1973. The panel did permit recovery of money spent before December 1, 1973, at one school, apparently in reliance upon a memorandum of advice from an attorney advisor to the Board, a department employee, which "advice" was couched in mandatory terms. The panel upheld the following "violations:"

> (1) Gardendale Elementary School in Edgewood I.S.D. was out of compliance on pupil-teacher ratios by .2, .6 and .1 out of about 27 on the dates audited, or an average non-compliance of about 1%. Recommended refund - all Title I money spent that year - $33,922. Shortfall of State and local expenditures - Probably about $750.
>
> (2) Two schools in San Antonio I.S.D. had insufficient annualized expenditures per child of .24¢ and .30¢ on one audit date. Recommended recovery - $9,443 - Shortfall of state and local expenditures - $95.04.

The panel did not discuss issues of substantial compliance or size-grouping but did note that the state had executed its administrative obligations. The panel further concluded that the comparability regulations "could be described perjoratively as a set of 'moving targets.' " Panel Decision p. 5.

Thus an audit of five Texas school districts, including Fort Worth and San Antonio, for comparability compliance in its second year, showed that *three* schools were out of strict compliance, without consideration of size-grouping. These three schools had fallen about $845 short in state and local expenditures out of over $600,000 actually spent at these schools. When the state and local money spent in all five districts for all Title I schools is considered, one is looking at a "non-compliance" of $845 out of over 20 million dollars. The State believes that "services as a whole" were comparable and that it should have been congratulated on the job it did in implementing Congressional will, not penalized. *See Wheeler v. Barrera*, 417 U.S. 402, 420 (1975), (comparable does not mean identical).

While the state and federal government had expended considerable resources to reach this point of the controversy on such an incredibly minimal matter, resources that otherwise would have been directed at present compliance and other services to the federal and state educational systems, the worst was yet to come.

M. On January 20, 1983, the Secretary of Education issued a decision reinstating the entire claim and remanding the matter to the Board, even though part of the reduction had not been challenged by the Department. The Secretary based his decision on a bare claim that "the State has not met its burden (of proof)." It was not explained how the State had failed to do so, nor could it have been. Since the Secretary's office does not receive the record of the appeals, but only the Comments on the Panel Decision of the parties, there was no way he could have known whether the State had met its burden. Rather, the reasons for the remand were 1) pressure from the Inspector General's office, which was furious over the Panel Decision, and 2) that the Secretary did not want to let cases go to the courts while *Bell v. New Jersey and Pennsylvania* was pending in this court but would not stay the cases for fear that it would be perceived by this Court as a sign of weakness. The latter reason was alluded to in a memorandum recommending the remand. An accompanying memorandum stated:

> It seems likely that at some point, a court is going to read a "substantial compliance" or "rule of reasonableness" standard into ED actions for refund of mispent Title I funds. I don't think it would be appropriate for the Secretary to do this (or in fact for the EAB to do it). We will either have to wait for a court decision or pursue legislation.

Texas wonders why it is not "appropriate" for the Secretary to require ED actions to be reasonable; isn't *he* supposed to be in charge and isn't his fairness a vital ingredient in the appeals process? No explanation is offered. A plausible explanation is that the memorandum may be read as saying: don't *you* take the heat from the Inspector General and, derivitively, the fraud, waste and abuse idealogues.

N. Texas sought to present the matter to the 5th Circuit Court of Appeals on the ground that the Secretary's decision was not for "good cause shown", 20 U.S.C. §1234a(d)(1); however, the Department secured a dismissal due to lack of finality.

O. Mr. Saner, the author of the Panel Decision, was not renewed on the Education Appeal Board in spite of the strong recommendation of the Chairman thereof. Information in workpapers, Review of Education Appeal Board, ACN 11-30002 (1984).

P. Texas' case was reassigned to a new Panel.

Q. In a second recorded conference with Dr. Staehle, which was obtained only by threat and cajolement, he stated that his opinion and the general consensus within the Department was that "not allowing size-grouping" in the determination of comparability "was not reasonable."

R. In January, 1984, the Inspector General audited the Education Appeal Board characterizing the Board as part of the "debt collection effort." While the workpapers are full of materials pointing to delays in appointment of Board members, often to secure political (ideological?) clearance, as a primary cause of delays in cases, the final audit makes no mention thereof. The audit criticized the Board for hear-

ing "what we consider to be insubtantial motions." Three of the four examples are obviously *not* insubtantial. They are:

1. Challenges to Board statutes or regulations. *See Bell v. New Jersey and Pennsylvania.*

2. Challenges to the burden of proof resting on appellant.

3. Motions for oral argument.

S. As of November 29, 1984, Texas continues to expend its educational resources in a fight against what is perceived as rear guard oppression. The audit is based upon regulations the Department's expert agrees are unreasonable and interpretations thereof having "no basis in the regulations or other directives," and would evaporate under the proper standard of substantial compliance applied to even the unreasonable regulations or under the proper retroactive application of the 1976 regulations. And yet the Department of Education persists.

II. Letter pertaining to Texas Comparability Audit. Appeal of State of Texas, Petitioner's Exhibit 1.

Department of Health Education, and Welfare
Audit Agency
Dallas Regional Office

To: Albert J. Benz
Assistant Director

Date: November 4, 1975

From: Regional Audit Director, Region VI

Subject: Audit Policy Regarding Recommendations on ESEA I Comparability Audits

This memo concerns the appropriateness and advisability of recommending a full financial refund from an SEA in a case when one or more LEAs were found to be out of compliance with ESEA I comparability regulations. Until last fall, we had taken the position that a comparability audit should normally be an audit of procedures which would result at most in recommendations for changes in those procedures. We believed that a recommendation for a financial refund would be excessively harsh, since most benefiting schools would undoubtedly be comparable and most of the children served -- everything else being proper -- would have received valid compensatory educational assistance.

Last fall, at the urging of the DSLA staff, we agreed to take what we consider to be the hardest possible stand and request the Texas SEA to refund all FY 1974 money made available after December 1, 1973 to four LEAs which we found to be out of compliance. Incidentally, we had an opportunity to discuss this position with OE Associate Commissioner John Rodriguez while he attended an exit conference on another audit. Mr.

Rodriguez also encouraged us to take this hard stand so that OE would be in a better position to negotiate with the SEA. However. Mr. Rodriguez stated that OE at that time was expecting an outside ruling calling for prorating any questioned funds between comparable and non-comparable schools and calling for a refund only on Title I money given to non-comparable schools.

For the Texas exit conference, we presented a draft recommendation that the SEA refund over $7.6 million of Title I funds made available after December 1, 1973 to four LEAs. At the exit conference the SEA expressed the opinion that this recommendation was too harsh, and made the statement -- which we did not verify -- that it would have taken less than $50,000 of expenditures to bring all of the schools in question into full comparability.

We are not only concerned about the harshness of a recommendation for a full refund from a non-complying LEA, but we also have questions about the actual legal support for that position. First, the regulations -- as well as all other guidance we have received from OE -- are written on the assumption that non-comparability is discovered during or before the applicable program year. The regulations and guidance call for an SEA, once noncomparability has been determined, to withhold *further* funds for that program year until comparability is attained (45 CFR 116.26(c)(3)). The regulations do not address the issue of refunds covering money already spent during that program year. More importantly, they do not cover the issue of discovery in a subsequent year of previous noncomparability and the legal support for a refund of past expenditures in that situation.

Second, the regulations do not directly require an SEA to question or review the accuracy of LEAs' comparability reports. The regulations state that SEAs shall make comparability decisions from the data submitted to them by LEAs. In the case in Texas as an example, the SEA did make the proper comparability decisions based on the data LEAs submitted to it. The regulations are silent as to what financial penalties, if any, an SEA or LEA assumes if the accuracy of the reported comparability is challenged after the program year in question. The best source, of which we are aware, concerning interpretations of the comparability regulations is an internal OE memorandum dated July 24, 1973 from Duane J. Mattheis to Associate Commissioner Robert Wheeler entitled "Implementation of Comparability Requirements." However, this memo also does not address the issues of subsequent discovery of noncomparability pertaining to a previous year, retroactive SEA or LEA financial penalties, and SEA responsibilities for verifying the reported data.

Third, the comparability regulations and related guidance are not sufficiently specific in the methodology for determining comparability. In the course of our audits we have had to make regulatory interpretations which we believe are equitable but which have no basis in the regulations or other directives. Examples include the handling of part-time special education students and part time special education instructional staff, proration of supervisory instructional staff, staff working at moe than one location, and instructional materials and supplies purchased and used up during the previous two years.

Assuming that we did take the hardest possible stand and ask for a full refund, and assuming that OE were to support us against the SEA's objections, we must consider the fact that a $7 million dispute such as the case in Texas will undoubtedly go to the courts. We do not beleive that the regulations are sufficiently specific in the areas of (1) SEA responsibilities and (2) SEA/LEA financial liability from the subsequent detection of past noncomparability for the Federal side to win the case.

When Mr. Stepnick recently visited Region VI, he discussed a number of issues with us, including relationships with POCs, overemphasis on dollar recoveries, and underemphasis on correcting basic problems and applicable procedures. The Texas comparability report was then discussed in this context, and Mr. Stepnick expressed concern as to whether a better approach might be to recommend procedural changes to the SEA and leave the issue of a financial adjustment up to OE.

Considering the vagueness of the comparability regulations, we believe the task of determining financial sanctions, if any, should be given to OE, perhaps accompanied with an internal recommendation that the regulations and related guidance be revis-

ed to cover adequately the issues of after-the-fact financial adjustments, SEA responsibilities concerning the verification of reported comparability data, and a clarification of procedures and methodology for the areas we have cited.

While we definitely prefer to leave the issue of financial sanctions up to OE, we request your guidance as to which position to take. Our Texas report, ACN: 06-60004, and our new Mexico report, ACN: 06-60000, will be affected by your decision.

GLYNDOL J. TAYLOR

RESPONDENT'S

BRIEF

No. 83-1798

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1984

T. H. BELL, SECRETARY OF EDUCATION, ... Petitioner

versus

KENTUCKY DEPARTMENT OF EDUCATION, ... Respondent

On Writ of Certiorari To The United States Court of Appeals For The Sixth Circuit

BRIEF FOR THE RESPONDENT

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QUESTION PRESENTED

Whether The Court of Appeals for the Sixth Circuit Applied a Proper Legal Standard of Review Under the Circumstances of This Case Thereby Denying Retroactive Recoupment of Allegedly Misapplied Title I Funds.

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IN THE

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T. H. BELL, SECRETARY OF EDUCATION - *Petitioner*

v.

KENTUCKY DEPARTMENT OF EDUCATION - - - - *Respondent*

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR RESPONDENT

COUNTERSTATEMENT OF THE CASE

1. Title I of the Elementary and Secondary Education Act (ESEA) of 1965, 20 U.S.C. (1976 ed.) 241a et seq.[1] established financial support to Local Educational Agencies (LEAs) to meet the special educational needs of educationally deprived children residing in school attendance areas having high concentrations of children from low income families. The legislative history of Title I reveals the intent of Congress was

[1]For an adequate legislative history regarding revisions of Title I, see Brief for the Petitioner, 2 n. 1.

to place full responsibility with LEAs and State Educational Agencies (SEAs) to develop programs to meet the needs of educationally deprived children.[2] The basic philosophy of Title I has been found to be that of placing as little federal control as possible over the actual administration of the programs created by the LEAs and SEAs.[3]

In no small part due to the Chairmanship of the Committee on Education and Labor by the late Congressman from Kentucky, Honorable Carl D. Perkins, Kentucky was acutely aware that the needs of educationally deprived children from low income families could be assisted through Title I programs. To meet the needs of some of the Title I eligible children in Kentucky, so-called "readiness class programs" were designed to provide children with the background and

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[2]See *Wheeler* v. *Barrera*, 417 U. S. 402, 415-416, 94 S. Ct. 2274, 41 L. Ed. 2d 159 (1974), where this Court stated: "The legislative history, the language of the Act, and the regulations clearly reveal the intent of Congress to place plenary responsibility in local and state agencies for the formulation of suitable programs under the Act. There was a pronounced aversion in Congress to 'federalization' of local educational decisions. 'It is the intention of the proposed legislation not to prescribe the specific types of programs or projects that will be required in school districts. Rather, such matters are left to the discretion and judgment of the local public educational agencies since educational needs and requirements for strengthening educational opportunities for educationally deprived elementary and secondary school pupils will vary from State to State and district to district.' HR Rep. No. 143, 89th Cong. 1st Sess., 5 (1965); S. Rep. No. 146, 89th Cong., 1st Sess., 9 (1965)."

[3]See *United States* v. *Farrell*, 418 F. Supp. 308, 310 (D.C. Pa. 1976).

experience they needed to start learning.[4] The readiness classes were largely self-contained and consisted of school age children who received a special educational program rather than the regular first, and in some instances, second grade instruction. Initial Decision, Education Appeal Board, App. to Pet. for Cert., hereafter "Pet. App.", 22a (Finding #2). The self-contained classroom procedure was developed in Kentucky based upon sound educational reasoning and because of the belief that these children selected for the readiness programs would not do well with traumatic changes in environment. Id., Pet. App. 22a (Finding #3). It was believed to subject these children to two types of classrooms — the readiness program and the regular first grade — would have been grossly detrimental to their educational progress. The self-contained procedure was, however, accompanied with auxiliary educational programs, referred to as "enrichment programs", such as physical education, music, art and library and guidance services. Id., Pet. App. 22a (Finding #5.) The salaries of the readiness classroom teachers were paid from Title I funds; the entire cost of the enrichment programs was paid from State and local funds. Id., Pet. App. 22a (Finding #5). There was no reduction at all of State funds to the LEAs that had self-contained readiness programs. Id., Pet. App. 22a (Finding #6.)

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[4]The Secretary admitted the design of and decision to use a "self-contained classroom procedure" was reserved to the local authorities. Brief for the Petitioner, 25 n. 17.

An audit of Kentucky's Title I programs and expenditures was conducted for the period July 1, 1967, through June 30, 1974. Joint Appendix, hereafter "J.A.", 11. The audit report was sent to the Superintendent of Public Instruction, Commonwealth of Kentucky, on October 29, 1976. The final determination letter with respect to the Title I audit, issued by the Deputy Commissioner for Elementary and Secondary Education, was sent to the Superintendent of Public Instruction on December 6, 1976. J.A. 22-23.

The stated primary objective of the federal audit in Kentucky "was to determine whether the SEA's administration of the Title I program had resulted in the design and implementation of fiscal year 1974 Title I projects to meet the special educational needs of educationally deprived children having the greatest need for assistance and residing in eligible attendance areas." J.A. 11-12. The audit procedure used by the audit team was basically that of sending questionnaires to school districts in Kentucky that had readiness program classes. J.A. 12. The key questions contained in the questionnaire were (1) Is the program self-contained, and (2) If the decision were made today, how many of these children would be promoted to the next grade level. If the question as to self-containment was answered in the negative, no exception was taken to the program. In 50 Kentucky LEAs involved with readiness programs, the answer to "self-containment" was in the affirmative, so exception was taken.[5]

[5]In 1974, there were 185 LEAs in Kentucky. During fiscal year 1974, approximately 69 LEAs proposed readiness programs as a part of their Title I project. J.A. 16.

J.A. 20-21; 27. As to the second question, in the 50 LEAs, the responses indicated that 865 first grade children and 244 second grade children were expected to be promoted, or a total of 1,109. J.A. 16. The total number of Title I eligible children participating in readiness programs in the 50 LEAs was 2,604. J.A. 16. During fiscal year 1974, about $1.65 million had been budgeted to be expended for services to students enrolled in self-contained Title I readiness programs. J.A. 14.

The Education Appeal Board's Initial Decision ruled "that the readiness programs carried out by the 50 LEA's during FY 1974 *were not properly designed* to supplement state and local expenditures for Title I children, that a supplanting violation did occur . . . ." (Emphasis supplied). Pet. App. 19a. In view of the determination by the auditors that the estimated per pupil expenditure for a child in a readiness program was $635.02, this figure was multiplied by 1,109, the number of children expected to be promoted out of a readiness class, to arrive at a total of $704,237.00, the amount determined to have been owed by Kentucky before the Secretary reduced the amount to $338,034.00.

2. A post-audit determination by the United States Secretary of Education relative to the expenditure in a state of Title I funds is judicially reviewable. 20 U.S.C. § 1234d. Kentucky exercised this statutory right by petitioning for a review by the United States Court of Appeals for the Sixth Circuit. Kentucky had argued throughout the administrative proceedings and on appeal in the Court of Appeals that the Secretary

lacked statutory authority to require a refund of Title I funds expended during FY 1974. It was contended that not until a 1978 amendment to Title I, 20 U.S.C. § 2835, was authority gained by the Secretary to make a demand for refund payments based upon a determination that provisions of Title I had been violated by an SEA.

In support of this argument that refund payments could not be a proper determination by the Secretary, Kentucky had, before the Secretary and the Court of Appeals, placed great reliance upon the Third Circuit Court of Appeals' decision in *State of New Jersey, Dept. of Ed.* v. *Hufstedler,* 662 F. 2d 208 (3d Cir. 1981). Such reliance proved unwarranted for this Court's decision on the Third Circuit's holding, *Bell* v. *New Jersey,* —— U. S. ——, 103 S. Ct. 2187, 76 L. Ed. 312 (1983) was dispositively against Kentucky's argument. *Bell* v. *New Jersey* established unequivocally by a unanimous Court, the right of the federal government to recover Title I funds misused by the States.

This Court's decision in *Bell* v. *New Jersey, supra,* was rendered just two weeks before oral argument of the present case in the Court of Appeals. Conceding as it had to the authority for demanding a refund of Title I funds argument, Kentucky turned to an alternative argument that there had been at no time a supplanting of Title I funds. In so doing, Kentucky urged the Court of Appeals to address the significant issue that had been "left open in *Bell*" which had been highlighted by Justice White in his concurring opinion in that case. And the Court of Appeals did just that. The

Court of Appeals then stated that "In the instant case, we must address this 'significant issue' left open in *Bell.*" 717 F. 2d at 945; Pet. App. 5a. The Court of Appeals then quoted from Justice White's concurrence in *Bell* v. *New Jersey,* —— U. S. ——, 103 S. Ct. 2187, 2199, 76 L. Ed. 2d 312, 329, as follows:

> "[these cases] . . . . do *not* involve any question as to the substantive standard by which a claim that a recipient has violated its Title I commitments is to be judged. Rather, they concern the abstract question whether the Secretary has the right to recover Title I funds under any circumstances. *In my view, there is a significant issue whether a State can be required to repay* if it has committed *no more than a technical violation of the agreement* or *if the claim of violation of the statute issued after the state entered the program and had its plan approved.* (Emphasis added by Court of Appeals). 717 F. 2d at 945; Pet. App. 5a.

Although indicating it was unclear what standard should be employed by the court "in reviewing the determination of the Secretary," the Court of Appeals acknowledged that some guidance had been provided by the following language of the opinion expressing the unanimous view of this Court in *Bell* v. *New Jersey,* —— U. S. ——, 103 S. Ct. 2187, 2198, 76 L. Ed. 2d 312, 328:

> "[T]he States have an opportunity to litigate in the courts of appeal whether the findings of the Secretary are supported by substantial evidence and *reflect application of the proper legal stand-*

ards. § 455, 20 USC § 1234d(c); 5 USC § 706. (Emphasis added by Court of Appeals). 717 F. 2d at 945; Pet. App. 5a.

SUMMARY OF ARGUMENT

The Court of Appeals was required to address the significant issue left open in *Bell* v. *New Jersey,* —— U. S. ——, 103 S. Ct. 2187, 2199, 76 L. Ed. 2d 312, 329 (1983) as identified in Justice White's concurring opinion in order to fulfill its obligation to decide whether findings by the Secretary are supported by substantial evidence and whether there has been a reflection of the application of proper legal standards. The Court of Appeals fully considered the polarity of the interpretations of the Title I anti-supplanting provisions espoused by both Kentucky and the Secretary and determined that in view of the ambiguity of the legal provisions, Kentucky's interpretation was reasonable and the Secretary's could not be said to be unreasonable. In that an interpretation of statutory provisions is a matter obviously within the competence of a reviewing court, automatic deference to the agency's interpretation was not warranted especially where retroactive application of that interpretation would have created a penalization against the State for the recoupment of monies. The Court of Appeals determined that the Secretary's interpretation of the supplanting provisions would be deferred to in the future but that ". . . in the absence of unambiguous statutory and regulatory requirements, and in the presence of a specific grant of discretion to the Commonwealth to develop and administer programs it believes to be consistent with the intention of Title I, it is unfair for

the Secretary to assess a penalty against the Commonwealth for its purported failure to comply substantially with the requirement of law, where there is no evidence of bad faith and the Commonwealth's program complies with a reasonable interpretation of the law." 717 F. 2d at 948.

In applying proper legal standards to a determination by the Secretary as obligated to do by the decision of this Court in *Bell* v. *New Jersey, supra,* under the circumstances evidenced in this case, the Court of Appeals appropriately considered Kentucky's actions against a "failure to substantially comply" standard. In the absence of any other legal standard, and in view of the lack of adequate notice of its obligations and the Spending Power contractual nature of a Title I agreement, the Court of Appeals was correct in denying a retroactive recoupment of allegedly misapplied Title I funds against Kentucky.

ARGUMENT

THE COURT OF APPEALS FOR THE SIXTH CIRCUIT APPLIED A PROPER LEGAL STANDARD OF REVIEW UNDER THE CIRCUMSTANCES OF THIS CASE THEREBY DENYING RETROACTIVE RECOUPMENT OF ALLEGEDLY MISAPPLIED TITLE I FUNDS.

A. This Case Did Require the Court of Appeals to Address the "Significant Issue" Left Open in *Bell.*

Under the basically uncontested factual circumstances of this case, the Court of Appeals was correct in deciding that Kentucky was entitled to have a claim that it had violated its Title I commitments reviewed

against a substantive standard of substantial compliance. The Secretary does not want to face this issue and thus simply asserts that the "significant issue" identified in Justice White's concurrence in *Bell* v. *New Jersey*, ___ U. S. ___; 103 S. Ct. 2187, 2199, 76 L. Ed. 312, 329 (1983) is in no respect involved in the present case. Brief for the Petitioner, 15 n.7. Yet the Court of Appeals' entire decision is premised on the position that it "*must* address this 'significant issue' left open in *Bell*." (Emphasis supplied) 717 F. 2d at 945; Pet. App. 5a. Kentucky believes not only is the significant issue left open in *Bell* involved in the present case before this Court, but that it is the very heart of why the decision of the Court of Appeals must be affirmed. The accept the Secretary's position in this regard is inconsistent with this Court's conclusion in *Bell* v. *New Jersey, supra*, that while the Secretary does have authority to recover from States Title I monies improperly expended, that on an appeal of such a determination by the Secretary, it is the obligation of circuit courts of appeal to address "whether the findings of the Secretary are supported by substantial evidence *and* reflect application of the proper legal standards: § 455, 20 USC § 1234d(e); 5 USC § 706 USCA § 706 (Emphasis supplied) *Bell* v. *New Jersey*, ___ U. S. ___; 103 S. Ct. 2187, 2198, 76 L. Ed. 2d 312, 328 (1983). In addressing the " 'significant issue' left open in *Bell*," which is what "the substantive standard by which a claim that a recipient has violated Title I commitments is to be judged" (103 S. Ct. at 2199, 76 L. Ed. 2d at 329), the Court of Appeals recognized that

this case involved a serious difference of interpretation between the Secretary and Kentucky as to what constitutes a proper Title I program and, more specifically, what constitutes the improper "supplanting" of Title I funds. As this case well illustrates, how true it is that "words are chameleons, which reflect the color of their environment."[*]

Kentucky has never disagreed with the Secretary that one of the conditions in effect during fiscal year 1974 as to the use of Title I grant funds was the prohibition against the use of the funds to supplant state and local effort education monies. A supplementing rather than a supplanting with Title I funds is the required touchstone. However, the term "supplanting" was not defined in the Title I statutes or interpretative regulations nor is the term self-defining. The applicable statute at the time, 20 U.S.C. (1976 ed.) § 241e(a)(3)(B) read:

> "Federal funds made available under this subchapter will be so used (i) as to supplement and, to the extent possible, increase the level of funds that would in the absence of such Federal funds, be made available for non-Federal sources for the education of pupils participating in programs and projects assisted under this subchapter, and (ii) in no case, as to supplant such funds from non-Federal sources."

The key regulation, then codified at 45 C.F.R. § 116.17 (h) provided:

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[*]Attributed to Judge Learned Hand in *Meredith* v. *Commonwealth*, Ky. App., 628 S. W. 2d 887, 888 1982).

"Each application for a grant under Title I of the Act for educationally deprived children residing in a project area shall contain an assurance that the use of the grant funds will not result in a decrease in the use for educationally deprived children residing in that project area of State or local funds which, in the absence of funds under Title I of the Act, would be made available for that project area and that neither the project area nor the educationally deprived children residing therein will otherwise be penalized in the application of State and local funds because of such a use of funds under title I of the Act. No project under Title I of the Act will be deemed to have been designed to meet the special educational needs of educationally deprived children unless the Federal funds made available for that project (1) will be used to supplement, and to the extent practical, increase, the level of State and local funds that would, in the absence of such Federal funds, be made available for the education of pupils participating in that project; (2) will not be used to supplant State and local funds available for the education of such pupils; and (3) will not be used to provide instructional or auxiliary services in project area schools that are ordinarily provided with State or local funds to children in nonproject area schools."

Appropriately, the Third Circuit Court of Appeals, in *State of New Jersey* v. *Hufstedler*, 662 F. 2d 208, 211 (3d Cir. 1981), rev'd sub nom. *Bell* v. *New Jersey*, —— U. S. ——, 103 S. Ct. 2187, 76 L. Ed. 2d 312 (1983), commented:

> "Congress chose to rely heavily on the States to assure proper application of Title I funds, but committed to the Department the authority to adopt such rules and regulations as it deemed appropriate. Such a division of responsibility must inevitably lead to conflicts between the SEA's and the Department over the proper application of Title I funds."

Armed with the recognition that "supplanting" was the forbidden fruit in the Eden of Title I, as noted earlier, approximately 69 LEAs developed and had approved the self-contained readiness program for the delivery of education to children from low income families. It has to go without saying that Kentucky did not believe the self-contained readiness programs were in violation of the Title I anti-supplanting provisions. The Court of Appeals recognized the basis for this position was that the Kentucky LEAs "were supplementing the existing programs since their expenditures for existing regular classrooms remained at the same level." 717 F. 2d at 946; Pet. App. 7a. See also Education Appeal Board, Initial Decision, Pet. App. 22a (Finding #6).

It is helpful to note, in considering the supplanting case at bar, that in enacting legislation in 1970[7] to address concerns and complaints about supplanting,[8] Congress adopted not only the language codified at § 241e(a)(3)(B), which is directly in issue in this case, but also clause (C) which required that "State and

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[7]The "supplanting" provisions were added to Title I by an amendment—Pub. L. 91-230, § 109.

[8]See Senate Report No. 91-634, 1970 U. S. Code Cong. and Admin. News, pp. 2781-2782.

local funds will be used in the district of such agency to provide services in project areas which, taken as a whole, are at least comparable to services being provided in areas in such district which are not receiving funds under the subchapter . . . ." The so-called "comparability" provisions of clause (C) were intended to reach what has been termed a "conventional method of supplanting"[9] which was where State funds available for a school district or LEA were reduced by reason of the availability of Title I funds. The Secretary does not deny that this comparability requirement regarding supplanting was complied with by Kentucky. See Pet. App. 23a (Finding #7.) Nevertheless a litigated example of such supplanting has some bearing on the design of Kentucky's readiness program. In *Nicholson* v. *Pittenger*, 364 F. Supp. 669 (E.D. Pa. 1973), supplanting was determined in a situation where the LEA had used Title I funds to finance such education services as art and music in Title I school programs even though the same types of services in other schools (non-Title I) were paid for with state and local funds. In contrast, in Kentucky's Title I readiness programs, enrichment services in art, music, physical education, library and guidance services were paid for by state and local money just as they were in non-Title I schools. Kentucky's efforts to refrain from supplanting are obvious.

Two other factors relating to the design of Kentucky's readiness programs deserve consideration in

[9]See *Alexander* v. *Califano*, 432 F. Supp. 1182, 1187 n. 5 (N.D. Cal. 1977).

the context of the application of Title I supplanting laws and regulations. First, apparently there would have been acceptability and thus non-supplanting if the Title I eligible children participating in the readiness programs would have been in the regular school program for a portion of the day above and beyond the regular school program for art, music, physical education and other enrichment education, for in those instances where teachers answered the auditors' questionnaire that the classroom was not self-contained, no exception claiming supplanting was taken. J.A. 27. The Secretary even believed there was cause for consideration of this factor. In his first "Decision of the Secretary of Education" letter, dated August 27, 1981, the Secretary stated:

"3. It is understood that the long-standing policy of the Department of Education has been to allow for children to be pulled out of the regular classroom to receive Title I instruction without viewing such limited replacement as 'supplanting' if the 'pullout' was for a small portion of the normal school day, month, or year. Thus, the Education Appeal Board is hereby requested to consider whether the current Title I regulatory provision (34 CFR 200.94) is a codification of this policy and whether, either as a result of the policy or as a result of a regulatory codification of this policy, the State of Kentucky should be given credit for the 25% or some other percentage of the 'pull-out' instruction involved in this audit in lieu of being charged with damages for 100% of the time the Title I children were removed from the regular classroom." Pet. App. 34a-35a.

However, there was nothing in the law in 1974 that gave any support to some sort of magical percentage of additional regular instruction that in the absence of such turned a sound educational Title I program into a violation of law requiring a retrocative recoupment of Title I grant funds.

Secondly, in a Title I program where the design characteristic of self-containment was supposedly the fatal flaw and the reason supplanting was determined to have occurred, credit was still given in Kentucky's favor solely because the pupil/teacher ratio was low compared to that in a regular non-Title I classroom; 13-1 as compared to 27-1 for the funding of classroom units under Kentucky's State Foundation Program. This ameliorative circumstance was premised upon the rationale that the reduction in pupil/teacher ratio for children in the readiness classes constituted a "supplemental service" and supplanting to some extent should not be found. In the second and final "Decision of the Secretary of Education" letter dated March 19, 1982, the Secretary reduced Kentucky's liability for supplanting from $704,237.00 to $338,034.00, a 52% reduction based upon a calculation that Title I funds would only have been used to pay for 14/27 (or 52%) of the cost of the readiness classes. Pet. App. 39a-42a. Kentucky appreciated the reduction in the recoupment penalty, but the rationality for and consistency of this technical allowance goes begging.

Lastly, it was the success of the readiness programs that in large measure triggered the supplanting allegation. If a child in the first or second grade readiness

program was to be promoted to the next grade, supplanting was determined to exist. No repayment of Title I grant monies was required if the child was to return to the regular first or second grade. Pet. App. 23a-24a (Finding #9.) The supposed support for this demarcation was that the children who were not promoted would still receive a state and locally funded education for the grade in which they had been enrolled in the Title I readiness program. See Pet. App. 41a.

Based upon the above, it is not surprising that the Court of Appeals found that Kentucky's readiness programs complied "with a reasonable interpretation of the law." 717 F. 2d at 948; Pet. App. 12a.

However, the Court of Appeals also took the position that "it cannot be said that the interpretation posited by the Secretary is 'unreasonable'." (footnote omitted) 717 F. 2d at 946; Pet. App. 8a. The Secretary's interpretation of the Title I provisions was that in order for each Title I child to receive his fair share there could be no decrease in the per pupil expenditure of State and local support funds. The focus of the Secretary was on the "expenditure per pupil." 717 F. 2d at 946; Pet. App. 9a.

The Court of Appeals concluded that the "statutory and regulatory prohibitions against supplanting State and local funds with Title I funds can reasonably be applied with reference to expenditures at the level of the individual educationally deprived pupil [Secretary's view], rather than at the level of either the LEA, the school, the grade, or the classroom

[Kentucky's view]." 717 F. 2d at 947; Pet. App. 8a-9a. The Secretary has conceded that the validity of the Title I expenditures in issue in this case turned entirely upon which view was taken of the applicable Title I statute and regulation. Brief for the Petitioner, 15.

Although the polar interpretations of the Title I provisions in effect during fiscal year 1974 are important factors in this case, the outcome of the case before the Court of Appeals did not depend upon a "taking of sides." The Court of Appeals specifically stated that it was not their task on appeal "to review the reasonableness of the Secretary's interpretation of Title I section 241e(a)(3)(B) and regulation section 116.17(h)." (footnote omitted) 717 F. 2d at 947; Pet. App. 9a. Clearly the recitation of the difference in interpretation of the anti-supplanting provisions by Kentucky and the Secretary was to serve only as a backdrop for what the Court of Appeals believed its responsibilities were in view of this Court's decision in *Bell* v. *New Jersey*, — U. S. —, 103 S. Ct. 2187, 76 L. Ed. 2d 312 (1983), that is, to judicially review "whether the findings of the Secretary are supported by substantial evidence and reflect application of proper legal standards. § 455, 20 USC § 1234d(c), 1234(a) 1; 5 USC § 706." 103 S. Ct. 2187, 2198, 76 L. Ed. 2d 312, 328. The principle concern of the Court of Appeals was not whether the findings of fact by the Secretary were supported by substantial evidence. The facts were basically uncontested. 20 USC § 1234d(c) referenced by this Court in *Bell* v. *New Jersey, supra,*

demanded that "the findings of fact by the Board, if supported by substantial evidence, shall be conclusive." But that the findings of fact have been supported by substantial evidence is only half a loaf rather than all of it as argued by the Secretary. The findings of the Secretary must also reflect an application of the proper legal standards.

B. The Court of Appeals Applied A Proper Legal Standard Under the Circumstances of this Case.

The Secretary has failed to acknowledge the existence of 5 U.S.C. § 706, or its reference in the opinion of this Court in *Bell* v. *New Jersey* as above pointed out. 5 U.S.C. § 706, a part of the Administrative Procedure Act, establishes the standard of review which a court must use in reviewing the Secretary's action. An appellate court on judicial review is required: "To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning and applicability of the terms of an agency action. The reviewing court shall . . . (2) hold unlawful and set aside agency action, findings and conclusions found to be (A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law; . . ." 5 U.S.C. § 706(2)(A). While this Court has held this standard to be a restrictive one, a reviewing court has the responsibility to determine whether an agency's action was within the permissible scope of administrative judgment. *Citizens to Preserve Overton Park, Inc.* v. *Volpe*, 401 U. S. 402 (1971).

It is submitted the Court of Appeals properly adhered to this standard of review. The Court of Appeals determined that the proper legal standard under the circumstances of this case, and what it had to be concerned with in the appeal, was "the fairness of imposing sanctions upon the Commonwealth of Kentucky for its 'failure to substantially comply' [n. 8][10] with the requirements of section 241e(a)(3)(B) and 45 C.F.R. 116.17(h), as those requirements were ultimately interpreted by the Secretary." 717 F. 2d at 947; Pet. App. 9a. And, although the Secretary contends the Court of Appeals should not have, by having reflected an application of proper legal standards, the court also gave careful attention to Justice White's concern in this area expressed in *Bell* v. *New Jersey*, — U. S. —, 103 S. Ct. 2187, 2199, 76 L. Ed. 2d 312, 329 (1983) of "whether a State can be required to repay if it has committed no more than a technical violation of the agreement or if the claim of violation rests on a new regulation or construction of the statute issued after the state entered the program and had its plan approved."

Before reviewing the factors taken into account by the Court of Appeals in applying it, the standard of review used itself should be addressed. The Court of Appeals applied a substantial compliance standard in its consideration of the fairness of imposing upon Kentucky the penalty of retroactively paying back grant funds. In asserting this standard of "failure to sub-

[10]"8. See 20 U.S.C. § 1234b(a) and § 1234c(a) (1978) (where the Commissioner is said to act upon the belief that a recipient of funds had 'failed to comply substantially' with any requirement of law applicable to such funds)."

stantially comply," the Court of Appeals referenced by way of n. 8 the provisions of 20 U.S.C. § 1234b(a) and 1234c(a). Although it is true that these provisions respectively deal with the withholding of grant monies and with cease and desist orders regarding grant programs, the Court of Appeals was justified, in view of its responsibility to apply some proper legal standards, to use the fail to comply substantially standard to a retroactive, past-expenditure recoupment of Title I funds situation. The reason behind this position is in part, that absent any other standard expressed in the law, this is a standard of which Kentucky, as a Title I grant recipient was already aware. An even stronger validation for the use of the substantial compliance standard is that to use a more stringent standard would be inconsistent with a concern for fairness. While the Secretary seems to have some trouble dealing with the Court of Appeals' concern for "the fairness of imposing sanctions," this Court recently stated in *Heckler* v. *Community Health Services of Crawford*, —— U. S. ——, 104 S. Ct. 2218, 2224 m. 13, 81 L. Ed. 2d 42, 52 (1984), citing *St. Regis Paper Co.* v. *United States*, 368 U. S. 208, 229 (1967) (Black, J., dissenting) that :

> "It is no less good morals and good law that the Government should turn square corners in dealing with the people than that the people should turn square corners in dealing with their government."

Very little sense or fairness is discerned from an argument that in a retroactive audit review situation where

the Secretary may seek a recovery of allegedly misspent funds, as this Court determined in *Bell* v. *New Jersey, supra,* a strict compliance standard would be the proper standard of review, but a substantial compliance standard is all that is needed in situations of withholding funds, a sanction having only prospective effect. And, lastly, the use by the Court of Appeals, of "fairness to substantially comply" standard of review must not be considered in isolation, but instead must be considered in the context of the factors that weighed heavily in its application in this case, that is, the extent of adequate notice of obligation to a grantee of funds due to the ambiguity of applicable statutes and regulations.

C. It Would Not Have Been Appropriate for the Court of Appeals to Have Accorded The Secretary's Position Undue Deference in This Case.

The Secretary suggests that the Court of Appeals was fatally in error in applying the substantial compliance standard because the Court should have simply deferred to the Secretary's interpretation of the law. However, agency deference is not automatic and in fact it may be argued that it is dangerous to defer automatically to an agency's view. See *Bethlehem Steel Corp* v. *United States E. P. A.*, 723 F. 2d 1303 (7th Cir. 1983). An attitude of agency deference must have its limits or an application of proper legal standards by a reviewing court would be virtually without meaning. The matter here involved one of interpretation of laws, which is an issue particularly within a court's area of competence. Moreover, and very im-

portantly, the laws to be interpreted in effect constituted the language of a contract more about which will be discussed below. Consequently it cannot be said to have been improper for the Court of Appeals to have declined to blindly defer to the position of the Secretary in this Title I case. A court should be able to review the issues "with confidence . . . [the court's] participation will contribute to the rationality and fairness of agency decisionmaking without detracting unduly from its effectiveness." (note omitted). *Natural Resources Defense Counsel, Inc.* v. *S.E.C.*, 606 F. 2d 1031, 1049 (D.C. Cir. 1979).

The string of cases cited by the Secretary in support of the principle of deference, for example, *Udall* v. *Tallman*, 380 U. S. 1 (1965), *Red Lion Broadcasting Co., Inc.* v. *Federal Communications Commission*, 395 U. S. 367 (1967), and *Batterton* v. *Francis*, 432 U. S. 416 (1977), are all really quite easy to distinguish as each of these cases supporting agency deference primarily involved long standing interpretations of laws or policies or involved statutory provisions which authorized an agency head to "define" a term in a statute. Such is not the situation with respect to Title I and supplanting. Plainly the anti-supplanting language found in Section 241e(a)(3)(B) and in the interpretative regulation, Section 116.17(h) having been enacted in 1970, predate fiscal year 1974 for only a relatively short time. In reviewing this case, the Court of Appeals fully and properly indicated deference would be given for prospective application saying "the interpretation of the Secretary governs all future dealings."

717 F. 2d at 948; Pet. App. 12a. For the Court of Appeals to have given deference to the Secretary under the circumstances of the present case, where such deference would have had retroactive effect on the recoupment of grant money, would have been unfair. While the Secretary suggests, citing this Court to *Indiana* v. *Bell*, 728 F. 2d 938 (7th Cir. 1984) and *West Virginia* v. *Secretary of Education*, 667 F. 2d 420 (4th Cir. 1981) (Brief for the Petitioner, 17, n. 8) that other Courts of Appeal have followed the principle of deference and have accepted the Secretary's interpretation of the statutory and regulatory requirements in Title I audit situations, the significant void in each of these cases is a failure to apply "proper legal standards" as this Court concluded was required with a Title I determination by the Secretary.

D. The Spending Power Analysis by This Court in *Pennhurst* Supports the Court of Appeals' Application of a Proper Legal Standard.

The most fundamental basis supporting the Court of Appeal's application of legal standards centers around the Spending Power provision of the United States Constitution, Article I, § 8, cl. 1. The Secretary must agree that Title I was enacted in the exercise by Congress of the Spending Power. See *State of New Jersey* v. *Hufstedler*, 662 F. 2d 208, 214 n. 15 (3rd Cir. 1981, rev'd sub. nom. *Bell* v. *New Jersey*, — U. S. —, 103 S. Ct. 2187, 76 L. Ed. 2d 312 (1983). And, of course, the factor of importance with Spending Power legislation is that it is in the nature of a contract. This Court in *Wheeler* v. *Barrera*, 417 U. S. 402, 427 (1974)

spoke of the obligation upon State and local agencies to fulfill their part of the "Title I *contract* if they choose to accept Title I funds." (Emphasis supplied)

In considering the Spending Power provision the Court of Appeals justifiably relied upon this Court's first decision in *Pennhurst State School* v. *Halderman*, 451 U. S. 1 (1981).[11] See 717 F. 2d at 948-950; Pet. App. 12a-15a. This Court stated in *Pennhurst State School* v. *Halderman, supra*, 451 U. S. at 17 that:

> " . . . legislation enacted pursuant to the Spending Power is much in the nature of a contract: in return for federal funds, the States agree to comply with federally imposed conditions. The legitimacy of Congress's power to legislate under the Spending Power thus rests on whether the State voluntarily and knowingly accepts the terms of the 'contract'."

Basic contract considerations require a meeting of the minds; without a clear understanding of an offer there can be no knowing acceptance. The Court of Appeals determined that the Title I supplanting requirements in issue in the present case were not free from ambiguity and that it would be unfair to penalize Kentucky for its purported failure to comply substantially with

[11]Kentucky acknowledges this Court in *Bell* v. *New Jersey*, — U. S. —, 103 S. Ct. 2187, 2197, 76 L. Ed. 2d 312, 326, n. 17, commented that "The plain language of the statute is sufficiently clear, and ESEA meets *Pennhurst's* requirement of legislative clarity." However, Kentucky believes this was not meant to be a sweeping assessment encompassing and reflecting upon all parts of the Title I law, but rather only an indication of the strength of conviction that under Title I, recipients of grant funds may be held liable for funds they have misused.

those requirements. The Court of Appeals stated in this regard:

> "We disagree with the Secretary's conclusion that the statutory and regulatory provisions at issue were sufficiently clear to apprise the Commonwealth of its responsibilities under the Act. [note omitted].[12] It cannot be inferred that the Commonwealth had notice of its obligations." (Note omitted). 717 F. 2d at 947; Pet. App. 10a.

And, it is clear that Kentucky did not have an adequate notice of its obligations under its Title I contract relative to supplanting. Contrary to the Secretary's assertions to this Court the statutory and regulatory requirements on supplanting were not unambiguous. Not only did the Court of Appeals determine these provisions lacked legislative clarity to place Kentucky on notice of its obligations, but so did the Education Appeal Board who made the Initial Decision determining supplanting had occurred in Kentucky in the readiness programs. The Education Appeal Board stated:

> "There is some merit to the SEA's contention that it had no notice prior to the year in question of *precisely* what was required of it." (Emphasis in the original). Pet. App. 26a-27a.

[12]In note #9, the Court of Appeals rejected Kentucky's contention that the 1974 enacted "excess cost provision" was being retroactively applied by the Secretary. The Court of Appeals did observe, however, that "the new provision makes it abundantly clear that Congress could have used language in the original enactment which would have been less ambiguous and would have more fairly apprised the state of its obligations." 717 F. 2d at 947, n. 9; Pet. App. 10a.

And it is nearly always "precision" of language that makes all the difference in the world in contractual compliance. Contract language should have the precision of a rifle shot and not the casualness of a shotgun blast. The condition of supplanting was understood by Kentucky but the interpretation and gloss provided by the Secretary on this condition was not.

The Secretary would have this Court limit the application of the *Pennhurst* analysis of the Spending Power to only those situations where the grant language, that is the contractual language, places an affirmative financial obligation on the States. While the affirmative obligation effect was admittedly a factor of importance in this Court's *Pennhurst* decision, it is not believed, in view of the nature of the Spending Power constitutional provision, that such a narrow construction is authorized. The Court of Appeals was correct in determining that this Court's decision in *Pennhurst State School* v. *Halderman, supra,* was fully applicable to the present case.[13]

[13]The Secretary infers that an improper application and reliance upon *Pennhurst State School* v. *Halderman* is evidenced by the Court of Appeals in the present case and that the Sixth Circuit correctly recognized the limitation of *Pennhurst* in *Kentucky* v. *Donovan*, 704 F. 2d 288, 299-300 n. 17 (1983). Brief for Petitioner, 29. Not only was the *Donovan* case decided before the present one but the point being made therein was only that Congress could delegate to agencies the power to create contract conditions so long as they are not unanticipated and detached from the original design of the law, a matter not in issue herein.

E. The Application of a Proper Legal Standard Must Be on a Case by Case Basis.

Without so much as even acknowledging the full obligation of review placed upon the Court of Appeals in *Bell* v. *New Jersey,* — U. S. —, 103 S. Ct. at 2198, 76 L. Ed. 2d at 328, the Secretary suggests the Court of Appeals standard of review in the present case has created an open season for grantees and subgrantees to adopt "relaxed interpretations of federal expenditure restrictions and to resist audit exceptions whenever the grant requirement alleged to have been violated is ambiguous in the slightest way. (note omitted)." (Brief for the Petitioner, 31). However, this case was not one evidencing in the slightest an attempt by a grantee or subgrantee to "get by" with something that was questionable through a "relaxed" interpretation of the law. Kentucky established and operated its Title I self-contained readiness programs in good faith as the Court of Appeals so held. 717 F. 2d at 948; Pet. App. 12a. The Federal Office of Education was aware of the self-contained readiness programs and had sent review teams to visit Kentucky LEAs having such programs and who never challenged the validity or legality of these programs. Education Appeal Board, Initial Decision, Pet. App. 23a (Finding #8). While this "finding of fact" was attempted to be minimized by the assertion that there was no evidence in the record to support a conclusion "that these teams [Office of Education Program Review Teams] actually reviewed the fiscal arrangements under which the readiness programs were financed" (Pet. App. 23a),

the Secretary would have this Court curtail its application of proper legal standards so as to strengthen the ability to recover misspent grant funds by suggesting Kentucky had a duty to "seek clarification" if it did not understand the ambiguous Title I provisions respecting supplanting. Such an argument is actually quite disheartening. With all due respect, this Court could probably take judicial notice of the fact federal education officials are not much help in responding to questions. Their responses are, at best, beige. Application of proper legal standards to review an agency's decision cannot reflect any rationality or fairness if an expectation of receiving clarification from the federal agency is to be superimposed upon the grant contract. Irrespective of all of this, however, the point is it simply does not follow that the application of a proper legal standard under the circumstances of this case has created "unworkable conditions" on the recovery of grant funds. As to each case, the Courts of Appeal must still determine "whether the findings of the Secretary are supported by substantial evidence and reflect application of the proper legal standards. § 455, 20 USC § 1234d(c); 5 USC § 706 ." *Bell* v. *New Jersey,* —— U. S. ——, 103 S. Ct. 2187, 2198, 76 L. Ed. 2d 312, 328 (1983).

CONCLUSION

"[I]n the absence of unambiguous statutory and regulatory requirements, and in the presence of a specific grant of discretion to the Commonwealth to develop and administer programs it believes to be con-

sistent with the intentions of Title I, it is unfair for the Secretary to assess a penalty against the Commonwealth for its purported failure to comply substantially with the requirements of law, where there is no evidence of bad faith and the Commonwealth's program complies with a reasonable interpretation of the law." 717 F. 2d at 948; Pet. App. 12a. The Court of Appeals applied an appropriate substantive standard in reviewing whether Kentucky had violated its Title I commitments.

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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AMICUS CURIAE

BRIEF

(9)

No. 83-1798

IN THE
Supreme Court of the United States
OCTOBER TERM, 1984

T.H. BELL, SECRETARY OF EDUCATION,
Petitioner

v.

KENTUCKY DEPARTMENT OF EDUCATION

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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BRIEF AMICUS CURIAE OF THE NATIONAL ASSOCIATION OF COUNTIES, THE INTERNATIONAL CITY MANAGEMENT ASSOCIATION, THE NATIONAL LEAGUE OF CITIES, THE U.S. CONFERENCE OF MAYORS, THE NATIONAL CONFERENCE OF STATE LEGISLATURES, AND THE COUNCIL OF STATE GOVERNMENTS

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INTEREST OF THE *AMICI*[1]

The *amici* are organizations whose members include State, city and county governments and officials located throughout the United States. Constitutional issues affecting the relationship between the federal government and State and local bodies are of vital importance to *amici* and their membership. This is especially true in cases, such as this one, involving the increasingly pervasive system of cooperative spending programs financed by the federal government and administered by State and local governments. *Amici* are concerned that the

[1] Letters from counsel for the parties consenting to the filing of this brief have been submitted to the Clerk.

position of the federal government in this case, if adopted by the Court, could substantially and deleteriously affect the relationship between the federal government and State and local governments. *Amici* therefore file this brief urging affirmance.

SUMMARY OF ARGUMENT

Everyone in this case agrees that in 1974 federal law prohibited the use of Title I to supplant State and local funds.[2] No one agrees on what that means. This is not surprising. As the General Accounting Office (GAO) found in 1980, this sort of confusion is inherent in the concept; it is far easier to bar supplanting in principle than to define it in practice. *See infra* note 15. For this reason, the GAO found, the numerous federal grant programs that forbid supplanting have never been able to define it consistently, and most have given up trying.

The Department of Education is no stranger to such confusion. In this very case, Kentucky encountered three levels of administrative review—the auditors, the Education Appeal Board, and the Secretary of Education—all of whom tendered different, and inconsistent, interpretations of the anti-supplanting provision. Before the case began, Department officials had sanctioned yet a fourth interpretation—Kentucky's. The Department sent teams of officials to the State each year between 1968 and 1974. These teams were specifically charged with monitoring Kentucky's compliance with Title I. From

[2] Title I of the Elementary and Secondary Education Act (ESEA), Pub. L. No. 89-10, 79 Stat. 27, 20 U.S.C. §§ 241a *et seq.* (1976). The Act was amended and reorganized in the Education Amendments of 1978, 20 U.S.C. §§ 2701 *et seq.*, and superseded by Chapter I of the Education Consolidation and Improvement Act of 1981, 20 U.S.C. §§ 3801 *et seq.* The government agency administering the Act at the time here relevant was the Office of Education of the Department of Health, Education and Welfare. The Department of Education, petitioner here, assumed this function on May 4, 1980. *See* 20 U.S.C. §§ 3411, 3441 (1982). For the sake of simplicity, this brief will refer to the Department of Education.

1968 through mid-1973, when Kentucky accepted the fiscal 1974 funds at issue here, no Department representative cast the slightest doubt on Kentucky's interpretation. No wonder. As a report commissioned by Congress reveals, it was Kentucky's interpretation that still held sway in the Department's highest reaches as late as 1977, three years after this case began. *See infra* pp. 17-21.

But the question here is not which of the Department's several positions is most reasonable. The question is whether a large financial penalty may be imposed on Kentucky because Kentucky's 1973-74 interpretation is no longer the Department's.

This question is answered by *Pennhurst State School & Hospital v. Halderman*, 451 U.S. 1 (1981). Congress has no inherent power to decide how much money Kentucky should spend on particular students; its power in this case depends on Kentucky's knowing and voluntary acceptance of the conditions that went with Title I funds. *Rosado v. Wyman*, 397 U.S. 397, 420-21 (1970). But, as *Pennhurst* recognized, there is no knowing, no voluntary surrender of State power when the federal government "surpris[es] participating States with postacceptance or 'retroactive' conditions." *Pennhurst*, 451 U.S. at 25. The requirement that federal grant conditions be stated clearly is no new departure. Without a clear expression of Congress's intent, this Court has long been reluctant to interpret federal laws in ways that intrude deeply on traditional areas of State decision-making. *See, e.g., Edelman v. Jordan*, 415 U.S. 651 (1974); *Parker v. Brown*, 317 U.S. 341 (1943).

The rule in *Pennhurst* is supported not only by principles of federalism but also by simple fairness. The contract that was created when Kentucky accepted Title I funds should be construed against the party that drafted it—indeed the only party with power to vary it—the United States. This elementary principle of contract law has long applied to the federal government.

Garrison v. United States, 74 U.S. 688 (1869). Nor can it be avoided by casting the Department's action as the retroactive application of a new rule of law, for the retroactive application of this rule would work manifest injustice. *Cf. Greene v. United States*, 376 U.S. 149 (1964). Kentucky, after all, is not being forced to disgorge the fruits of some unjust enrichment; it kept only one percent of the Title I funds at issue here. 20 U.S.C. § 241g(b) (1976). The rest was passed on to local school districts which spent it to educate children. "Recoupment" of funds the State never had is nothing more or less than a fine. Such a penalty should not be imposed on a State that has in good faith acted on a reasonable interpretation of an ambiguous grant condition.

ARGUMENT

I. KENTUCKY ACTED IN GOOD FAITH

The court of appeals below was correct in determining that Kentucky acted in good faith. Pet. App. at 12a. As the record demonstrates, Kentucky used its Title I funds to develop a highly successful, "showcase" program to aid educationally deprived children; federal management review teams reviewed the program in every year from its inception in 1968 to 1973 without the slightest suggestion of a compliance problem; and Kentucky took immediate steps to discontinue it upon the first announcement of a federal change in policy in 1974.

1. Kentucky joined the Title I program shortly after its enactment. Among the problems that Kentucky hoped Title I would address was a serious deficiency in the reading readiness of some children entering the first grade. Working with local school districts, Kentucky devised an innovative educational program to address the problem in a comprehensive way. As described by Kentucky's director of Title I programs, the result was "a concentrated program with a small pupil/teacher ratio where the teacher was specially trained, and the program was specially designed to meet the unique needs of those

children who qualified for such programs."[3] In order to preserve the supplementary nature of Title I funds, Kentucky was careful to maintain previous levels of State and local funding for each school, and indeed for each grade, that had a readiness program.

2. The State was pleased with the results of its experiment. "This type of program had achieved such success in school districts that first implemented it, that we encouraged other school districts to review the program and to establish similar programs." EAB Ex. 2. Kentucky was eager to show off the program not only to its own school districts but also to the federal Department of Education. When the Department dispatched management review teams to see how well Kentucky was spending Title I funds, State officials insisted that the teams examine school districts with the program:

> We were quite proud of the programs as they developed and made it a point to be sure that such programs were reviewed by the management review teams when they made their program review along with other programs in the school districts.

Id.

The specific mission of these management review teams was to determine whether Kentucky was implementing Title I in accord with federal law.[4] EAB Tr. at

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[3] EAB Ex. 2. Although the docket sheet for the Education Appeal Board proceedings is part of the Joint Appendix, J.A. 4-7, it appears that this Court may not have a full record of the EAB proceedings before it. The transcript of the EAB hearing, to be found at Item 25 of the administrative record, will be cited as "EAB Tr. at ——." Exhibits, found at Item 16 of the record, will be cited as "EAB Ex. ——." Because the Department "decided not to file any rebuttal evidence," EAB Item 17, all testimony quoted in this section of the brief is uncontested.

[4] In a comprehensive report commissioned by Congress in 1974, the National Institute of Education explained the purpose of these reviews as follows:

> *Program Reviews.*—[The Department's] Division for Education of the Disadvantaged (DED) conducts annual monitor-

37. From 1968 through 1973, these teams reviewed Kentucky's readiness program "each year, [and] in no year did they miss entirely schools that had this type of program." EAB Tr. at 50. At no time during this period did federal officials suggest that the services being provided were supplanting the regular school program. And despite the fact that State and federal officials "did discuss specifically how the programs were funded," *id.*,[3]

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ing visits to each State and to districts within each State. The visits are designed to insure that SEA administration of Title I complies with the statute and regulations. After approval by the Associate Commissioner for Compensatory Educational Programs, reports and recommendations are sent to the State's chief state school officer. Where changes appear necessary, States are expected to respond by informing [the Department] of the action they plan to take. If the problems identified by the Review Team are serious, and the State refuses to alter its policies or procedures, a hearing process is begun. Title I funds may be withheld if the State is unsuccessful in making its case during the hearing. In the choice of regulations to monitor and the resulting recommendations, therefore, program reviews can influence state and local perception of their responsibilities under the Title I legal framework.

In addition to conducting such formal fact-finding, Review Team members, once in the field, are often asked by state and local officials to provide ad hoc technical assistance in the form of advice on how to implement different regulations. These less formal interactions also provide significant indications to SEAs and LEAs of the importance Federal administrators attribute to various Title I rules and regulations.

National Institute of Education, *Administration of Compensatory Education* 27 (1977) [hereinafter cited as NIE Report].

[3] There is some confusion in the record on this point. The Education Appeals Board stated that there was nothing in the record about whether federal review teams discussed the funding of this program with state officials. Pet. App. at 23a. This is inaccurate, as the quotation above demonstrates. The confusion arises because immediately after the statement quoted above, the Department's lawyers objected that they would need time to prepare for cross-examination if such testimony were admitted. Kentucky offered to put on more extensive testimony, subject to cross-examination, about the statements of the review teams, a motion the EAB ultimately denied on the ground that such testimony would be relevant only

federal officials never suggested during this period that the fiscal arrangements for the program violated Title I.

Kentucky relied on the Department's review of these districts in deciding to expand the readiness program.

> It was not a program we felt uncomfortable with, but because they were reviewed by the management review team, because no exceptions had been taken, and because the educational results were so successful, we actually treated the program as a "showcase."

EAB Ex. 2.

In 1974, when the Department's management review team and auditors first announced a policy inconsistent with the program, Kentucky complied immediately:

> If we had known that it would have been the position of the auditors and the management review team in 1974, that the child who completed the readiness program successfully and was promoted to the second grade in the second year would constitute "supplanting" and would result in a claim against the LEA's, then, of course, we would never have initiated the program in that manner. For the first time in 1974, the management review team took exception to the program . . . . We immediately took steps to discontinue the program and to assist the local education agencies in establishing programs to comply with the management team report and the 1974 changes in the Title I law.

Id. If the Department's management review teams, or any other federal official, had suggested that Kentucky's program violated Title I, the State would have revised its program immediately. No audit, no fine, no punishment

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to the question of estoppel. If the Court concludes that the record on this point is inadequate, it would be appropriate to remand for further findings of fact concerning the extent to which Kentucky discussed its program with the management review teams. *Amici* believe, however, that the present record amply demonstrates Kentucky's good faith.

would have been required to change Kentucky's administration of the program.

Thus, the record clearly supports the court of appeals' holding that Kentucky acted in good faith in its administration of Title I funds.

II. KENTUCKY'S INTERPRETATION OF THE CONDITIONS AT ISSUE WAS REASONABLE

The court of appeals further held that Kentucky's interpretation of the "supplanting" prohibition was reasonable. Pet. App. at 12a. Again, the court's holding has abundant support in the record. At the very least, the meaning of the regulation was ambiguous—as demonstrated by the three differing interpretations advocated by the Department in this very case.

A. The Conflicting Interpretations at Issue

To understand the difference between Kentucky's interpretation of the anti-supplanting provision and that of the Department, it may help to use a single example, drawn in part from the record in this case. Sacramento Elementary School, located in rural McLean County, Kentucky, had 37 first graders in 1973-74. EAB Ex. 9. Because of budget restrictions, a poor school like Sacramento Elementary ordinarily taught all 37 students in a single class, paying the teacher's salary with State and local funds. Kentucky's reading readiness program, however, allowed a school like Sacramento to use Title I funds to hire a second teacher to teach 10 or 15 of the most educationally deprived students in a separate and much smaller class. Some children in the readiness class went on to first grade at the end of the program. Others benefited even more and were promoted into the second grade. The issue is whether such a program improperly supplants State and local education funds.

The State's view in 1973-74 was that such a situation caused no supplanting; so long as State and local funds

continue to pay for one first grade teacher at Sacramento, the second teacher was supplementary. In the Department's current view, such a program does cause supplanting because educationally deprived children are being educated entirely with Title I funds; in the absence of Title I, the Department contends, State and local funds would have been spent to educate these children. The conflicting interpretations thus boil down to whether supplanting should be measured at the school or grade level, or, as the Department now urges, at the level of the individual student. The Department argues that its view is self-evident from a literal reading of the anti-supplanting rules in effect in 1973-74.

As the administrative proceedings below demonstrate, however, nothing is self-evident about the Department's reading of the anti-supplanting rules. In this case alone, officials of the Department have already found three different—and inconsistent—ways to apply anti-supplanting rules to Kentucky's readiness program. The view of the Department's auditors, for example, was that using Title I to pay the second teacher's salary would supplant State and local expenditures only to the extent that the readiness program succeeded in advancing students beyond the first grade. Under this view, a readiness student who went from the program to the first grade caused no supplanting, while one who went directly into the second grade had his or her first grade experience entirely supplanted. Pet. App. at 23a-24a, 30a. The Education Appeal Board took a second and more extreme view. It would have recouped every dollar of the second teacher's salary on the theory that every child in the readiness program would otherwise have been in a first grade class at State and local expense. Pet. App. at 30a. A third interpretation emerged at the third level of review. There, the Secretary of Education focused on the supplementary effect of the services the Title I students received; because learning to read in a class of 15 is a substantial improvement over learning to read in a class of 37, he concluded, roughly half of the Title I funds

supplemented, and half supplanted, State and local funds. Pet. App. at 38a-42a.

Whatever else one may say about each of these positions, one cannot say that they are inevitable deductions from the language of Title I or the Department's regulations. The fact is that the Department's current position (or positions) evolved over nearly twenty years of administrative review—punctuated in 1970, 1974, 1978, and 1981 by major legislative overhauls of the Title I program. The history of these years demonstrates that Kentucky's reading of the supplanting provision was entirely reasonable in 1973-74.

B. The History of the Supplanting Prohibition

From the outset, Title I of ESEA was intended as a supplementary program, with the "purpose of broadening and strengthening public school programs in schools where there are concentrations of educationally disadvantaged children."[6] Although there was no specific language in the original Act to that effect, both the Department and a variety of advocacy groups monitoring compliance with Title I interpreted it to prohibit supplanting of existing State and local efforts.[7]

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[6] S. Rep. No. 146, 89th Cong., 1st Sess., *reprinted in* 1965 U.S. Code Cong. & Ad. News 1446, 1451.

[7] The first Title I regulations, adopted in 1966, evidenced a concern about supplanting but did not spell out in detail how the provision was to be applied. *See* 45 C.F.R. § 116.17(f) (1966). By 1969, the regulation had been revised to read as follows:

> Each application for a grant under Title I of the Act for educationally deprived children residing in a project area shall contain an assurance that the use of the grant funds will not result in a decrease in the use for educationally deprived children residing in that project area of State or local funds which, in the absence of funds under Title I of the Act, would be made available for that project area and that neither the project area nor the educationally deprived children residing therein will otherwise be penalized in the application of State and local funds because of such a use of funds under Title I of the Act. For the purposes of this paragraph, the failure to use State or local funds to provide to a project area or to children residing therein services comparable to those services which have been, or are to be, generally provided to other areas or children will be deemed to constitute a penalization of that project area or of those children. No project under Title I of the Act will be deemed to have been designed to meet the special educational needs of educationally deprived children unless the funds made available for that project are to be used to supplement, and not supplant, State or local funds.

45 C.F.R. § 116.17(h) (1969).

[8] Program Guide 44, para. 7.1. This program guide, and others referred to herein, have been lodged with the Clerk for the Court's convenience.

In its *amicus* brief at 28 n.57, the Lawyers' Committee for Civil Rights Under Law suggests that a November 1968 program guide declared that programs such as Kentucky's would violate the sup-

The types of activities that were considered supplanting, however, were very different from the readiness program that led to a finding of supplanting in this case. In the late 1960s, two primary concerns emerged: that programs already funded with State and local money would be funded instead by Title I money in Title I schools, depriving poor children of the advantage of Title I funds; and that States would use Title I funds simply to bring poor schools closer to the level of services already provided in wealthier areas. These two issues, later separated into the concepts of "supplanting" and "comparability," were both referred to as supplanting throughout the late 1960s. Thus, in March, 1968, the Department explained the supplanting prohibition as follows:

> The instructional and ancillary services provided with State and local funds for children in the project areas should be comparable to those provided for children in the non-project areas . . . . Title I funds, therefore, are not to be used to supplant State and local funds which are already being expended in the project areas or which would be expended in those areas if the services in those areas were comparable to those for non-project areas.[8]

Later in 1968, the Commissioner of Education explained the anti-supplanting policy in Program Guide 45:

> Title I, ESEA, funds are intended to supplement and not supplant State and local funds. This policy is set forth in the Title I regulations and in the assurances which applicants sign when they submit their applications. Applicants are required to maintain in each eligible attendance area a level of expenditure that is at least equal to the level of expenditure that would be maintained if Title I funds were not being expended in that area. The Title I applicant that reduces its level of expenditure in an eligible attendance area forfeits its right to participate in the program.

The point was repeated once more that year in Program Guide 45A:

> [S]*upplanting* means the use of Title I funds for purposes for which State and local funds are being used *or* would be used if the services provided with such funds in the Title I areas were *comparable* to those provided in the other attendance areas.

In 1969, an influential report on Title I was released by two advocacy groups, the NAACP Legal Defense and Educational Fund and the Southern Center for Studies in Public Policy. Washington Research Project, *Title I of ESEA: Is It Helping Poor Children?* (1969). A portion of that report, which has been lodged with the Court, also identified two types of supplanting violations: "Equalizing Poor Schools with Other Schools," *id.* at 16-19, and "Assuming the Funding of Programs Previously Supported by State and Local Funds," *id.* at 19-21. The

planting prohibition unless State and local funds contributed to the project. But this program guide does not purport to construe the anti-supplanting rules and, in contrast to others, was clearly not mandatory in nature. This becomes clear when the Lawyers' Committee quotes the opening lines of this program guide (in a separate footnote): "The purpose of this memorandum is to *suggest* an *approach* to the planning of Title I programs which can result in improved program quality." *Id.* at 26 n.51 (emphasis added).

latter section of the report detailed instances in which schools "use Title I money to support programs and services which were paid for by local funds before Federal money became available, or to provide identical services to all schools but charge Title I for these services in target schools." *Id.* at 19. The nine specific examples of abuse cited by the report included actions such as canceling commitments of local funds for construction of classrooms and building instead with Title I funds; charging Title I for teachers' salaries previously paid by local funds; and using Title I to pay for television systems at Title I schools while installing the same systems at non-Title I schools with State and local funds.

Not one of the instances cited by the advocacy groups' report or the Commissioner involved the definition of "supplanting" now urged by the Department: a pupil-by-pupil comparison of expenditures of State and local funds to ensure that each child receives equal amounts of such funds.

In response to the advocacy groups' report and other problems in Title I administration, Congress in 1970 amended Title I to address, among other things, the problems of supplanting and comparability. The Senate report on the bill[9] made specific reference to the advocacy groups' findings regarding supplanting, and spoke approvingly of the Commissioner's efforts to enforce comparability between Title I and non-Title I schools by requesting one State to withhold approvals of local programs until the State had developed proper comparability criteria.[10] Nothing in the statute or legislative history indicates that either comparability or supplanting violations were to be determined at a pupil-by-pupil level; indeed, the Senate report stated that the amend-

[9] S. Rep. No. 634, 91st Cong., 2d Sess., *reprinted in* 1970 U.S. Code Cong. & Ad. News 2768, 2776-77.

[10] It is interesting to note that the enforcement technique approved by Congress was clearly prospective only.

ments do not "require the expenditure of equal amounts of State and local funds on all children." [11]

Following the 1970 amendments, the Department continued to focus on supplanting of particular services previously funded by States and localities, and to require that Title I schools continue to spend the same amount on instructional services as they did before Title I funds were available.[12] Neither these guidelines nor the applicable regulations stated that supplanting must be measured by comparing State and local expenditures on a pupil-by-pupil basis.[13] Not until 1974—well after the

[11] *Id.* at 2781. The report was discussing comparability at the time, but there would have been no point in offering such an assurance with respect to comparability if some other provision required pupil-by-pupil equalization of expenditures.

[12] *See, e.g.*, Advisory Statement on Development of Policy on Comparability (Sept. 18, 1970), at A7:

> ***Criteria for Meeting Supplementing and Non-Supplanting Requirement***
>
> The State educational agency shall find a local educational agency in compliance with the requirement against supplanting if the local agency either:
>
> 1. Does not use Title I funds to support a service which has been supported previously by funds from State or local sources, or
>
> 2. Establishes, with respect to funds from State and local sources, that both the per pupil expenditure for instructional services and the proportion of expenditures for instructional services (calculated on a per pupil basis) spent at the schools serving its Title I project areas will be maintained at levels at least equal to the levels which prevailed before State and local support for the service to be supported by Title I funds was discontinued.

This document has been lodged with the Clerk.

[13] The regulation in effect in 1974 was substantially the same as the 1969 regulation, quoted *supra* at note 7. The first sentence was identical to that of the 1969 regulation; the remainder read:

> No project under title I of the Act will be deemed to have been designed to meet the special educational needs of educationally deprived children unless the Federal funds made available for that project (1) will be used to supplement, and to the extent practical increase, the level of State and local funds that would, in the absence of such Federal funds, be made available for the education of pupils participating in that project; (2) will not be used to supplant State and local funds available for the education of such pupils; and (3) will not be used to provide instructional or auxiliary services in project area schools that are ordinarily provided with State and local funds to children in nonproject area schools.

45 C.F.R. § 116.17(h) (1974).

beginning of the fiscal year at issue here—did the Department declare that supplanting was to be measured student-by-student. Even then, the position was taken only in informal, unpublished letters:

> In 1974 [the Department] developed criteria for determining whether a fullday pull-out program is illegally supplantive. *This [Department] policy was not set forth in federal regulations or guidelines.* It appeared in letters written to at least two states.[14]

There were good reasons for the Department to proceed tentatively in this area. Establishing a clean "audit trail" was not the only—or even the most important—policy embodied in Title I. Of equal concern to Congress was the fostering of educational innovation and experimentation at the State and local level. Paired with this was Congress's firmly expressed intent to bar federal interference in the design of specific programs developed by State and local educators. Federal education laws are explicit on this point:

> No provision of any applicable program shall be construed to authorize any department, agency, officer, or employee of the United States to exercise any

[14] Lawyers' Committee for Civil Rights Under Law, Legal Standards Project, R. Silverstein & D. Schember, *An Analysis of the Basis for and Clarity and Restrictiveness of the Program Requirements Applicable to Local School Districts Applying for Grants under Title I of ESEA* 531 (1977) (emphasis added). This finding is especially significant because the report was written by an advocacy group urging application of supplanting standards at the intraschool level.

> direction, supervision, or control over the curriculum, program of instruction, administration, or personnel of any educational institution . . . .

20 U.S.C. § 1232a (1982).

While these policies are not necessarily inconsistent, in practice an unduly rigid set of auditing principles could easily become a federal straitjacket for compensatory education. That this was no imaginary danger is illustrated by the 1978 report of the House Committee on Labor and Education. Writing against the background of a decade's steadily tightening federal auditing rules, the report observed that the fear of costly audit exceptions based on misunderstandings of poorly written Title I rules has led many States to take the "safe" approach of merely replicating programs already approved by federal authorities. *See* H.R. Rep. No. 1137, 95th Cong., 2d Sess. 26 (1978), *reprinted in* 1978 U.S. Code Cong. & Ad. News 4971, 4996.[15]

Indeed, the tension between strict student-by-student auditing controls and local educational autonomy had

[15] The same point was made by the National Institute of Education, which was directed by Congress in 1974 to examine the administration of Title I. *See* § 821 of Education Amendments of 1974, Pub. L. No. 93-380, 88 Stat. 484, *reprinted in* 1974 U.S. Code Cong. & Ad. News 541, 679. The NIE Report was extremely critical of the Department of Education's lack of clear guidance on the meaning of supplanting: "This lack of clarity has not encouraged flexibility in program design; rather, it has discouraged the development of innovative programs. . . . [States] have interpreted unclear Federal direction restrictively for fear of approving illegal programs." NIE Report at 22. In 1980, a GAO report recommended elimination of supplanting prohibitions in all federal programs because enforcement of these provisions "inappropriately involves the Federal Government in speculative hypothesizing about future State and local plans [and] extends Federal control over State and local spending decisions . . . ." GAO, *Proposed Changes in Federal Matching and Maintenance of Effort Requirements for State and Local Governments* 72 (1980) [hereinafter cited as GAO Report]. The Reports have been lodged with the Clerk.

split the Department itself. During the mid-1970s, the question whether to tighten the anti-supplanting provisions by applying them to expenditures on individual students was the subject of a raging debate within the Department. This became clear after Congress in 1974 directed the National Institute of Education (NIE) to conduct a massive study of Title I and other compensatory education programs.[16] The resulting NIE Report revealed that as late as 1977 the Department was divided over the wisdom and legality of applying the anti-supplanting rule below the school level.[17] At that time, the Division for Education of the Disadvantaged (DED), which had immediate responsibility for the Title I program, took the position now urged by the Department. NIE characterized DED's views in terms that could have come from the Department's brief in this case:

> *Within-School Indicators.*—DED believes that the statutory provision that Title I funds be used ". . . for the education of pupils participating in the programs and projects . . ." requires an effort to monitor the use of funds below the school level, to guarantee that the individual students selected to participate in Title I actually receive supplementary services.

NIE Report at 32.

The NIE Report was written in 1977, and there is reason to doubt whether these statements reflect DED's position before 1974. It was DED's review teams, after all, that went to Kentucky each year from 1968 through

[16] *See supra* note 15.

[17] *See generally* NIE Report, *supra* note 4. The GAO Report in 1980 found continuing confusion over the proper method for applying supplanting prohibitions. Most of the nineteen largest federal programs containing a supplanting clause were enforced as though they contained a fixed level of effort provision in order to avoid speculation about what the State and local governments would spend on a program in the absence of federal funds. *See* GAO Report, *supra* note 15, at 54.

1973, discussed the funding of its readiness program, and raised no objection to the program during that period. *See supra* notes 4 & 5. But even if this were DED's position before 1974, it was not the Department's position even as late as 1977. DED's superior in the Department was the office of the Associate Commissioner for Compensatory Educational Programs (CEP), which had broad responsibility for all compensatory education programs. CEP's position differed from DED's but it will sound equally familiar. It is Kentucky's:

> CEP officials . . . believe that within-school indicators will never produce information sufficiently reliable to support a supplanting allegation. At present, it is impossible to determine precisely the funding sources of programs specifically provided pupils in a classroom. An analysis of the net impact of Federal funds at the pupil level, CEP officials argue, would require that schools keep detailed financial records, including daily records of the activities of each student and teacher. Such recordkeeping is highly impractical, they argue, which means that within-school indicators are inherently misleading and, therefore, unreliable.
>
> Furthermore, CEP officials are particularly opposed to within-school indicators because such monitoring and enforcement might reduce the autonomy of local school officials in determining their own programs.
>
> . . . .
>
> Consequently, CEP officials propose a school level test for intraschool supplanting. As one CEP official put it:
>
> > Because of the problems (of per-pupil accounting and political interference) associated with tracking funds below the school level, you have to stop at that level. You cannot go below the school level.
>
> Thus, according to CEP officials, "The ultimate test becomes whether the school saved money. If the school can show that the costs to the school have not decreased, then . . . (there has been no supplanting)."

Id. at 35.

The position of the supervisors at CEP was grounded in a belief that federal control over education should be limited to the minimum necessary to meet the statutory purposes:

> One CEP official spoke directly of CEP's belief that the Federal Government should restrict itself to the absolute minimum level of action consistent with the statute: "We believe in giving States maximum flexibility under the law. We believe in a strict interpretation of the law. This . . . is a question of proper governance."
>
> On the basis of that belief, CEP opposes DED's efforts to monitor or enforce the supplement not supplant prohibition if those efforts might affect the power of a school board or school principal to determine local curriculum.
>
> Moreover, CEP officials believe that the proper role of the Federal Government is to distribute funds, not to exert precise control over their use. . . .
>
> Given this approach to the Federal role, whenever CEP must choose between a limited or a comprehensive interpretation of a particular provision, the limited view prevails. This greatly restricts the kinds of operational tests CEP will approve for determining whether a supplanting violation has occurred.

Id. at 36.

The Department's failure to agree on a consistent interpretation of the anti-supplanting provision was found to have had a predictable effect on States and school districts:

> The conflict between DED and CEP over the Federal role has seriously affected [the Department's]

> ability to implement the supplementation provisions of the Title I legal framework. Direction to the field has been unclear and inconsistent.
>
> . . . .
>
> The confusion about the appropriate interpretation of the supplementation provisions might be expected to lead to difficulty in local school districts. Other studies conducted as part of the NIE evaluation confirm the existence of such difficulty.
>
> The Study of State Administration, for example, found the supplanting/general aid prohibitions to be among the most misunderstood features of the administration of the program at the local level.

Id. at 37, 39.

This indictment of the Department's administration of the anti-supplanting provisions was specifically adopted by Congress when it overhauled Title I in 1978. The House report on the 1978 amendments stated:

> The NIE provided evidence that [the Department] is implementing administrative requirements in a manner which is neither clear nor consistent, and that this inconsistency is confusing States and local educational agencies about their obligations. In particular, NIE found that [the Department] does not apply consistent standards in identifying violations of the "supplement, not supplant" requirements. Some [Department] officials administer the same requirement in different ways at different times. Furthermore, officials at various levels in the [Department] hierarchy administer the relevant requirements differently and the findings of program review teams and official audits are often reversed. . . .
>
> A second weakness in Federal administration deals with the clarity of the legal framework. The NIE found that the law and regulations are not written clearly enough to be understood by those who implement the program. In addition, [the Department] provides interpretation of this legal framework on

> an inquiry by inquiry basis and does not make clear in a general sort of way what are permissible activities. Many of the amendments discussed in the preceding sections of this report, as well as the overall rewriting of the statute, are intended to rectify this problem.

H.R. Rep. No. 1137, 95th Cong., 2d Sess. 49, 1978 U.S. Code Cong. & Ad. News at 5019. One of the "preceding sections of this report" put an end to the dispute between CEP and DED by adopting DED's view. *Id.* at 27, 1978 U.S. Code Cong. & Ad. News at 4997. But that was in 1978, five years after the 1973-74 school year at issue here.

Thus, the sole question in this case is the one left open by the Court in *Bell v. New Jersey*, 462 U.S. 356, 103 S. Ct. 2187 (1983): "whether a State can be required to repay [Title I funds] if . . . the claim of violation rests on a new regulation or construction of the statute issued after the state entered the program and had its plan approved." 103 S. Ct. at 2199 (White, J., concurring).

III. THE *PENNHURST* "CLEAR STATEMENT" DOCTRINE BARS RETROACTIVE APPLICATION OF THE ADMINISTRATIVE INTERPRETATION AT ISSUE

In *Pennhurst State School & Hospital v. Halderman*, 451 U.S. 1, 17 (1981), this Court held that: "There can, of course, be no knowing acceptance [of federal grant conditions] if a State is unaware of the conditions or is unable to ascertain what is expected of it. Accordingly, if Congress intends to impose a condition on the grant of federal moneys, it must do so unambiguously." This "clear statement" doctrine rests upon sound considerations of federalism, basic principles of contract law, and longstanding limitations upon the imposition of retroactive penalties.

A. Principles of Federalism Require that Grant Conditions Not Be Revised Retroactively

Through Title I, Congress and the Executive Branch engage in direct regulation of State and local governments as they carry out their most integral and traditional function. If instead of enacting Title I, Congress had simply ordered Sacramento Elementary School to spend more money on some children than others, that order would undergo intense judicial scrutiny because of its effect on the balance of federalism. *See FERC v. Mississippi*, 456 U.S. 742, 761-67 (1982); *National League of Cities v. Usery*, 426 U.S. 833, 856 (1976) (Blackmun, J., concurring). Title I escapes such scrutiny, not because its effect on federalism is diminished, but because the States have knowingly surrendered their traditional authority by accepting federal conditions along with federal aid. *Rosado v. Wyman*, 397 U.S. 397, 420-21 (1970); *Oklahoma v. United States Civil Service Commission*, 330 U.S. 127, 143-44 (1947).

This distinction has an obvious corollary: the requirement that there be "knowing acceptance" by the State of the conditions of the federal grant under which State power is surrendered. This requirement can hardly be satisfied by "surprising participating States with post-acceptance or 'retroactive' conditions," however clearly they may later be stated. *Pennhurst*, 451 U.S. at 25. The reasons for such a rule are clear:

> [T]he receipt of federal funds under typical Spending Clause legislation is a consensual matter: the State or other grantee weighs the benefits and burdens before accepting the funds and agreeing to comply with the conditions attached to their receipt . . . . When . . . it is [later] determined, contrary to the State's position, that the conditions attached to the funds are not being complied with, it may be that the recipient would rather terminate its receipt of federal money rather than assume the unanticipated burdens.

Guardians Association v. Civil Service Commission, 103 S. Ct. 3221, 3229 (1983) (White, J.).[18]

There is nothing new or radical about requiring a clear statement in these circumstances. This Court has often expressed its reluctance to order a drastic shift in the balance of federalism without a clear congressional intent to do so. *See, e.g., South-Central Timber Development, Inc. v. Wunnicke*, 104 S. Ct. 2237 (1984) (clear statement of congressional intent needed to authorize otherwise illegal State interference with interstate commerce); *Parker v. Brown*, 317 U.S. 341 (1943) (absent a clear expression of congressional intent, federalism concerns require that the Court will not assume that Congress intended antitrust laws to apply to States); *Edelman v. Jordan*, 415 U.S. 651 (1974) (clear statement of congressional intent required to overcome States' Eleventh Amendment immunity to suit). By the same token, even when States have the acknowledged power to substitute local for national policies, this Court has required them to state their intent to do so unambiguously. *Community Communications Co. v. City of Boulder*, 455 U.S. 40 (1982) (State's policy to extend its antitrust immunity must be clearly articulated and affirmatively expressed).[19]

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[18] A leading scholar in the field of federal grant law puts it this way:

> If the United States changes the grant rules either by statutory amendments or new regulations, the recipient must be free to recalculate the cost-benefit ratio and withdraw from participation . . . . Otherwise, the doctrine of consent would have neither real nor theoretical meaning.

2 R. Cappalli, *Federal Grants and Cooperative Agreements* § 10:09, at 21-22 (1982).

[19] The Department and the Lawyers' Committee argue that this case can be resolved by simple deferral to the administrative interpretation of Title I. Pet. Br. at 15-20; Lawyers' Committee *amicus* brief at 17-19. But the proper interpretation of the statute is not the issue in this case; rather, under *Pennhurst*, the issue is what the parties understood the terms of their contract to be at the time. *Cf.* Petitioner's Brief, *Bell v. New Jersey*, No. 83-2064, at 21: "The

B. Other Principles of Law Reinforce the Conclusion that Grant Conditions Should Not Be Revised Retroactively

1. Even in the absence of federalism concerns, basic principles of contract law prohibit the imposition of retroactive liability in a case such as this.[20] As the *Pennhurst* Court recognized, a State's acceptance of a federal grant creates a contract. 451 U.S. at 17. As such, the terms of the agreement are fixed at the time the contract is made, and cannot be revised retroactively. The Department itself has recognized that grant obligations are not ordinarily construed to wax and wane with changes in administrative policy:

> Viewed as a contract, it is not remotely plausible to construe the assurances as incorporating future changes in law. Neither [the recipient State] nor

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pertinent question must now be whether [the State] complied with its commitments as they were understood at that time." The Department is not entitled to deference on this point; indeed, to defer to the agency's interpretation of the contract would nullify the entire *Pennhurst* inquiry. Moreover, if the political safeguards of federalism are to retain their meaning, the Court must be wary of excessive deference to Executive "clarifications" of ambiguous congressional statements. *See* Tribe, *Intergovernmental Immunities in Litigation, Taxation, and Regulation: Separation of Powers Issues in Controversies about Federalism*, 89 Harv. L. Rev. 682, 695 & n.71, 711 & nn.136, 137 (1976); Wechsler, *The Political Safeguards of Federalism: The Role of the States in the Composition and Selection of the National Government*, 54 Colum. L. Rev. 543 (1954). *Cf. Hutto v. Finney*, 437 U.S. 678 (1978) (five Justices agree that clear language in legislative history can provide clear statement in Fourteenth Amendment context); *id.* at 705 (four dissenters would require clear statement in statutory language).

[20] *Heckler v. Community Health Services*, 104 S. Ct. 2218 (1984), is not to the contrary. There, a private grantee was required to repay funds received due to erroneous advice of the government's intermediary. It was clear, however, that the position advanced by the grantee and the intermediary was inherently unreasonable under applicable statutes and regulations. In addition, the grantee in *Heckler* was a private organization, not a State, so the federalism concerns underlying *Pennhurst* are absent.

> the federal government would ever have agreed to allow their legal rights and obligations to fluctuate with subsequent changes in congressional *or administrative policy*. . . . If the parties had intended their rights and obligations under the contract to fluctuate according to future changes in law, they surely would have said so. . . . The pertinent question must now be whether [the State] complied with its commitments *as they were understood at that time*.

Petitioner's Brief, *Bell v. New Jersey*, No. 83-2064, at 16, 21 (emphasis added).

The Department can hardly argue that grant conditions may be retroactively changed or clarified only in the Department's favor. Sauce and geese aside, when a federal grant is "viewed as a contract," it must be construed against its writer. This principle has been applied to contracts involving the federal government for more than a century, *see Garrison v. United States*, 74 U.S. 688 (1869), and maintains its vitality today. *See United States v. Seckinger*, 397 U.S. 203, 210 (1970) ("A contract should be construed most strongly against the drafter, which in this case was the United States."). Grant conditions are, after all, contracts of adhesion; negotiation, which might clarify ambiguities, is not permitted. Only the federal government is in a position to set forth grant requirements with specificity.

2. These principles are reinforced by the strict limits courts have imposed on attempts at retroactive rulemaking. It is of course possible to make new rules in an administrative adjudication if the end result is an injunction or other prospective relief. *See, e.g., SEC v. Chenery Corp.*, 332 U.S. 194 (1947). But the courts show no such tolerance for "adjudicative rulemaking" when the result is to impose a fine or damages on someone who acted in good-faith reliance on the agency's past position. *Heckler v. Community Health Services*, 104 S. Ct. 2218, 2224 n.12 (1984); *NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 295

(1974) ("[T]his is not a case in which some new liability is sought to be imposed on individuals for past actions which were taken in good-faith reliance on Board pronouncements. Nor are fines or damages involved here.").

The Department's resort to adjudicative rulemaking in this case is particularly unwarranted. The Department has full power to write formal regulations for Title I. *See* 20 U.S.C. §§ 241e(a), 242(b) (1982). Normally, an agency with both rulemaking and adjudicatory powers is expected to adopt new requirements through prospective regulations, not retroactive adjudications. *See* 2 K. Davis, *Administrative Law Treatise*, § 7:25, at 119 (2d ed. 1979). Labeling its retroactive rule an interpretation does not allow the Department to evade this responsibility. The Department has issued prospective interpretations in the past, sometimes with long-delayed effective dates. *See, e.g., Irving Independent School District v. Tatro*, 104 S. Ct. 3371, 3377 n.7 (1984) (Secretary twice put off the effective date of an interpretive ruling).

The Department also has means available to assure compliance *prospectively*, which is certainly preferable to declaring and then punishing "noncompliance" retroactively. If it finds that a recipient has "failed to comply substantially" with legal requirements, it may suspend and then withhold Title I funds, 20 U.S.C. § 1234b (1982), and it may issue a cease-and-desist order requiring future compliance, 20 U.S.C. § 1234c (1982). This is not only fairer to grantees, it is also more effective in ensuring that federal grant funds will be spent in the way Congress intended.[21]

[21] The Department argues that funds should be available for recoupment on a showing of failure of a strict standard of compliance, rather than the substantial compliance test used in the cited sections, because withholding interferes with ongoing programs while recoupment "involve[s] only after-the-fact adjustment of accounts." Pet. Br. at 22. This position borders on the ridiculous. First, if money is being spent in a way contrary to the wishes of Congress, "interference" with ongoing programs is not only justified but necessary. Second, it is plainly absurd that the Department should continue to fund programs that comply substantially, but not absolutely, with the law, all the while intending to recoup those same funds in a later audit action. This is no mere "adjustment of accounts," but an affirmative penalty.

3. Even if these procedural objections are laid aside, application of the general principles governing retroactivity would defeat the Department's claim. Where "manifest injustice" would result from retroactive application of a regulatory change, the change is given only prospective effect. *See, e.g., Greene v. United States*, 376 U.S. 149 (1964) (more restrictive new regulation concerning reimbursement of lost pay not applied where right matured under prior regulation); *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971) (judicial decision imposing statute of limitations not applied retroactively); *Cipriano v. City of Houma*, 395 U.S. 701, 706 (1969) (judicial decision imposed prospectively only to avoid "injustice or hardship").

Introducing retroactive new interpretations into a Title I audit is particularly unjust given the nature of the program. Despite the talk of "recoupment," Kentucky is not being forced to disgorge funds it used to enrich itself. Adhering to federal law, Kentucky used one percent of its Title I funds to pay the salaries of its program staff. The rest was passed on to local school districts, which spent it educating children. If anyone was unjustly enriched by Kentucky's failure to abide by the Department's current rule in 1973-74, it was non-Title I children like the twenty-five first-graders at Sacramento Elementary whose classes were smaller because the Title I children were in a separate class. Those first-graders will graduate from high school this year, and the Department does not propose a way to "recoup" from them the benefits they received. Instead, it seeks what amounts to a fine from the agency that acted as conduit for its funds. The burden of this penalty will fall on the current tax-

payers of Kentucky, who will have to pay higher taxes or accept fewer government services in order to repay the 1974 expenditures. Furthermore, the amount of the penalty is unrelated to either the gravity of the offense or the existence of wrongful intent on the part of the State, making the repayment even more unfair.

These considerations would not bar the Department from imposing liability if Kentucky had acted contrary to a provision of law that was clear at the time, or if its interpretation of the law was unreasonable or made in bad faith. *Cf. Bell v. New Jersey*, 462 U.S. 356, 103 S. Ct. 2187 (1983). In the absence of these conditions, however, retroactive liability is manifestly unjust.

C. Pennhurst Is Not Distinguishable

Despite the support that *Pennhurst* draws from principles of federalism, contract law, and retroactivity, the Department argues that *Pennhurst* is inapplicable here. The Department's distinctions, however, dissolve on examination.

1. The Department attempts to distinguish *Pennhurst* by stating that the supplanting prohibition was an explicit statutory condition in 1974. Pet. Br. at 27. This is true, but it is not a distinction. It is agreed that in 1974 Title I contained a provision on supplanting; but it was agreed in *Pennhurst* that federal law contained a handicapped "bill of rights." The question in each case was what the statutory language meant. There is no reason not to apply here the rule of construction applied in *Pennhurst*.

2. The Department argues that *Pennhurst* was a case in which the federal condition required affirmative expenditures of State funds, while the recovery sought here is limited to repayment of federal Title I funds. Pet. Br. at 27-28. Again what the Department says about *Pennhurst* is true. Again it is not a distinction. Unless the Department has a plan for recouping the disputed funds from the ultimate beneficiaries, the penalty in this case

will simply come from Kentucky's treasury. *Cf. Edelman v. Jordan*, 415 U.S. 651, 666 (1974).

Even if there were a difference between recoupments and affirmative expenditures, *Pennhurst* required a clear statement of grant conditions so that States' acceptance of the conditions could honestly be called voluntary. Surprising States with a new ground for recoupment is just as involuntary and objectionable a procedure as surprising them with some other expenditure requirement. *See Bell v. New Jersey*, 103 S. Ct. at 2197 n.17 (1983) (applying *Pennhurst* to ESEA recoupment action).[22]

3. The Department attempts to limit *Pennhurst* to actions brought by private plaintiffs, rather than audit disputes initiated by the federal government. Pet. Br. at 28. Why *Pennhurst* should apply only to third-party beneficiaries the Department does not make clear. Certainly it would be odd to have the courts interpreting the handicapped "bill of rights" one way for the federal government and another less favorable way for the handicapped themselves. If anything, the courts should apply a stricter standard to the federal government when it seeks a benefit for itself than when it regulates the relationship between third parties. *See Perry v. United States*, 294 U.S. 330, 350-51 (1935) ("There is a clear distinction between the power of the Congress to control or interdict the contracts of private parties when they interfere with the exercise of its constitutional authority, and the power of the Congress to alter or repudiate the substance of its own engagements . . . .").

In short, the Department has presented no credible argument why the *Pennhurst* rule should not apply. In the end, it is reduced to arguing that States might abuse a rule that protects them from retroactive liability where they apply in good faith a reasonable interpretation of an ambiguous grant condition. The Department suggests

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[22] The Department freely admits the applicability of *Pennhurst* to Title I recoupment issues when it suits its purpose. *See* Petitioner's Brief in *Bell v. New Jersey*, No. 83-2064, at 20.

that States would seize upon ambiguities and refuse to seek clarification, and that this would "eviscerate" the Department's ability to recoup misspent funds. Whatever the merits of this insulting argument in connection with private parties,[23] State and local governments exist not to make profits but to pursue the welfare of the same citizens as the federal government. They are subject to public scrutiny and to political checks that make abuses unlikely. What is more, should abuses occur, the rule in *Pennhurst* will permit recovery. A State that knows what a federal grant condition means when it takes federal money is bound by what it knew; its voluntary acceptance cannot be rescinded just because it later finds an ambiguity in the regulations. Nor can a State rely on an unreasonable interpretation of a statute and expect to find comfort in *Pennhurst*. There is no need for a rule that penalizes even States that are attempting to comply in good faith for the sake of catching a few that may not.

CONCLUSION

The decision of the court of appeals should be affirmed.

Respectfully submitted,

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[23] The federal government has a variety of powerful enforcement techniques to use when grantees act in bad faith. Those who purposefully obtain funds from the federal government under false pretenses may be prosecuted criminally, *see, e.g.*, 18 U.S.C. §§ 286, 287 (1982), and civilly, *see, e.g.*, 31 U.S.C. § 3729 (1982), as the Department admits. Pet. Br. at 30 n.21.

REPLY

BRIEF

No. 83-1798

In the Supreme Court of the United States

OCTOBER TERM, 1984

T. H. BELL, SECRETARY OF EDUCATION, PETITIONER

v.

KENTUCKY DEPARTMENT OF EDUCATION

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

REPLY MEMORANDUM FOR THE PETITIONER

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TABLE OF AUTHORITIES

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1. Despite repeated references to the alleged ambiguity of the statutory and regulatory anti-supplanting provisions, neither respondent nor the amici urging affirmance of the judgment below have responded to the invitation in our opening brief (at 36) to identify the language in the statute or regulations that is ambiguous. Still less have they cited *any* language that would permit the particular supplanting violation that occurred here—the use of Title I funds to pay for the basic education services the eligible children would have received in the absence of the federal grant.

Respondent and amici instead point to problems in the interpretation of the supplanting prohibition in unrelated contexts. We do not deny that other types of supplanting violations and other factual circumstances might present more difficult issues of statutory and regulatory interpretation. In such circumstances, which may well involve technical or un-

anticipated violations of Title I, the Secretary obviously would use administrative discretion and common sense in deciding whether to pursue recoupment of the misspent funds (and in exercising his grantback authority (see Pet. Br. 23 n.15)). But respondent's and amici's focus on these distinguishable situations should not be allowed to obscure or justify the clear and substantial violation in *this* case, which went to the heart of the Title I program.

Similarly, while respondent observes that the Education Appeal Board found " 'some merit to [respondent's] contention that it had no notice * * * of *precisely* what was required of it' " (Resp. Br. 26 (emphasis in original)), respondent fails to note that the Board went on to conclude that "there is evidence in the record that [respondent] was more fully aware of its obligation to prevent supplanting * * * than it wishes to admit in retrospect" (Pet. App. 27a). Indeed, had the LEAs given the assurance required by respondent's own project application forms—that Title I services be supplemental for the participating children—"and adhered to it, [respondent] would have been protected from an audit of this nature." *Ibid.* As the Board stated, "were this a closer case, [one might] be inclined to sympathize with [respondent's] predicament." *Ibid.*

Amici National Association of Counties, et al. (NAC), attempt to manufacture support for respondent's claim of ambiguity by stating that Department officials have "found three different—and inconsistent—ways to apply anti-supplanting rules to Kentucky's readiness program." NAC Br. 9. This argument is specious.[1] The auditors, the Board, and

[1] Amici assert (NAC Br. 3) that Kentucky's interpretation of the anti-supplanting provision "held sway in the Department's highest reaches as late as 1977." They cite no official interpretation in support of this assertion; it is certainly not supported by the statute or the Department's regulations. Instead, they refer to program guides issued in 1968—before the anti-supplanting provision was incorporated into Title I (see Pet. Br. 34-35)—finding it significant that the examples given therein did not include the type of supplanting violation involved here. The 1977 date is derived from a report by the National Institute of Education, *Administration of Compensatory Education* (NIE Report)), which criticized the Department for an internal disagreement about the practicality of and methods for enforcing the anti-supplanting provisions at the level of the individual student (NAC Br. 16-21); the report led to the legislative re-affirmation of the need for the enforcement of precisely those controls. Moreover, the NIE Report indicates that despite whatever misgivings one mid-level Department official (the Associate Commissioner for Compensatory Educational Programs) may have had about the methodology for determining supplanting violations in other contexts, he approved the final determination letter to respondent in this very case (NIE Report 40-41 n.30). Apparently, therefore, there was no internal disagreement about the conclusion that respondent's readiness programs violated the anti-supplanting requirements. Furthermore, any internal disagreement only concerned the methodology for enforcing the anti-supplanting provisions and "the proper role of the Federal Government in implementing educational policy" (NIE Report 35-36); the existence of a disagreement of this nature hardly supports the assertion of respondent and amici that the statutory and regulatory requirements were ambiguous. In any event, respondent could not have relied on any "internal disagreements" reported in 1977 when the challenged expenditures were made in FY 1974.

the Secretary disagreed in part in determining the amount of state and local funds supplanted by Title I funds, and as a result, the Secretary finally reduced the required refund from $704,237 to $338,034. But there was no disagreement among these officials on whether a supplanting violation had occurred,[2] and

[2] Thus, the Board's "uneasiness about the manner in which the claim was calculated [did] not extend to the question of

most importantly, there was no disagreement among these officials that the supplanting prohibition applied to the *children* participating in the Title I program, rather than just to the grade, school, or school district level as alleged by respondent.[3]

Thus, as we explained in our opening brief (at 15-16 n.7, 37-38), this case does not involve either a "technical violation * * * or * * * a new regulation or construction of the [Title I] statute."

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whether a supplanting violation occurred." Pet. App. 19a-20a. The Board found "ample evidence in the record to sustain that finding." *Ibid.* Likewise, the Secretary's action in reducing the refund amount was based on the supplemental benefit provided to readiness students as a result of the reduced pupil-teacher ratio in those classes, and not on any interpretation of the statute and regulations contrary to that expressed by the auditors and the Board. See Pet. App. 38a-42a.

[3] Even the NIE Report relied on by amici NAC agreed with the basic principle, disputed by respondent and amici, that the anti-supplanting requirement applies at the level of the individual child. In describing the Title I anti-supplanting requirement, this report explained (NIE Report 10 (footnote omitted)):

> *Supplement not supplant* requirements apply at the child level and to the use of funds. They are intended to insure that Title I funds are added to, and not used to replace, state and local funds. Children in Title I programs must receive the level of state and local funds they would have received if Title I did not exist.
>
> The supplanting provisions of the statute and the regulations add significantly to the restrictions on local spending behavior contained in the maintenance of effort and comparability requirements. Maintenance of effort refers to district-level expenditures, while the comparability requirements relate to services provided at the school level. The supplanting provision, in contrast, requires that Title I funds be used to provide supplementary programs for individual, educationally disadvantaged children.

Bell v. *New Jersey*, No. 81-2125 (May 31, 1983), slip op. 2 (White, J., concurring).[4] Nor, as respondent appears to suggest (Resp. Br. 10, 21-22), did the Court in *Bell* v. *New Jersey* require the development of a special standard of review for Title I cases. Instead, as with other cases involving judicial review of administrative action, the Administrative Procedure Act, 5 U.S.C. 706(2)(A), provides the correct standard of review. Accordingly, once the court of appeals concluded that the Secretary's interpretation of the anti-supplanting provision was reasonable, it was required under this standard to uphold the agency action.[5]

2. Respondent and amici nevertheless argue that such deference is inappropriate here, relying on the principle ("*contra proferentem*") that ambiguous contract terms are to be interpreted against their author. Even if the anti-supplanting provisions had been ambiguous, this argument would be unpersuasive. Although, as the Court noted in *Pennhurst State School & Hospital* v. *Halderman*, 451 U.S. 1, 17 (1981), federal grants are "much in the nature of a contract," the analogy is not perfect.[6] While con-

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[4] The statute and regulations violated by respondent were in effect several years prior to 1974, and the Secretary's interpretation is based on the clear language of those provisions. As amici Texas, et al., acknowledge (Br. 26), "this is not a substantial compliance case * * *. If Kentucky should have known that its program was violative of the supplanting regulations then that violation was clearly substantial."

[5] The same interpretation can hardly be both not " 'unreasonable' " (Pet. App. 8a-9a) and reversible as "arbitrary, capricious, [or] an abuse of discretion" under 5 U.S.C. 706(2)(A).

[6] Indeed, even the court below concluded that the Secretary's interpretation of the allegedly ambiguous term should govern all future expenditures. In this regard, even assuming the

tracts govern only the relations between the parties to them, legislation and regulations further public policies. A principle that statutory or regulatory ambiguities are to be construed against the government would frustrate those policies and thus would be flatly inconsistent with the principle that legislation is to be interpreted " 'in light of the purposes Congress sought to serve.' " *Norfolk Redevelopment & Housing Authority* v. *Chesapeake & Potomac Telephone Co.*, No. 81-2332 (Nov. 1, 1983), slip op. 5 (quoting *Chapman* v. *Houston Welfare Rights Organization*, 441 U.S. 600, 608 (1979)). See also *Watt* v. *Western Nuclear, Inc.*, No. 81-1686 (June 6, 1983) (noting the inherent ambiguity of the statutory term "mineral," but nevertheless concluding that gravel is a mineral reserved to the United States under the Stock Raising Homestead

validity of a ruling that the same grant terms mean one thing for past expenditures and another for future expenditures, it is difficult to understand why the dividing line should be the date on which the Sixth Circuit placed its judicial imprimatur on the Secretary's concededly reasonable interpretation of the anti-supplanting provisions.

The better analogy in this context is with cases like *United States* v. *Michigan*, 190 U.S. 379, 401 (1903) (citations omitted), in which the Court construed federal legislation granting property to the state to facilitate the construction of a canal. The Court there stated: "where words are ambiguous, legislative grants must be interpreted most strongly against the grantee and for the Government * * *. Any ambiguity must operate against the grantee and in favor of the public. This rule of construction obtains in grants from the United States to States or corporations in aid of the construction of public works." It also, we submit, obtains in grants from the United States to states or private entities in aid of other federal policies, such as aid to education. See *Grove City College* v. *Bell*, No. 82-792 (Nov. 29, 1983), slip op. 13; *North Haven Board of Education* v. *Bell*, 456 U.S. 512, 522 n.12 (1982).

Act of 1916 in light of the purposes of that Act). Moreover, in contrast to a contract, which normally is drafted to address specific conduct in a narrow context, legislation (and its implementing regulations) must necessarily address a wide range of conduct and cannot anticipate and deal specifically with every situation likely to arise thereunder. As the Court stated in *Heckler* v. *Community Health Services*, No. 83-56 (May 21, 1984), slip op. 12, "[t]here is simply no requirement that the Government anticipate every problem that may arise in the administration of a complex [federal grant] program * * *."

This does not, of course, mean that grantees must interpret ambiguous legislative or regulatory provisions at their peril. Rather, as we explained in our opening brief (at 30-31), grantees can and should seek an authoritative administrative interpretation of such provisions when they are uncertain how to proceed.[7] Respondent and amici Texas, et al., baldly assert that such a request would have been futile in this case (Resp. Br. 28-29; Texas Br. 14-15),[8] but

[7] As the Board pointed out in its initial decision (Pet. App. 27a), if respondent "had some uncertainty about precisely how far it had to go in an operational sense [to comply with the anti-supplanting requirement] it should have sought further interpretation from the [agency] at the time."

[8] In this and other respects, amici Texas, et al., have larded their brief with strident complaints about the Department of Education's administration of the Title I program in general, and the audit process in particular, based in large part on their highly partisan account of a pending audit dispute (which concerns a different Title I requirement). There is no justification for interjecting these matters into this case; they certainly do not assist in the reasoned consideration of the issues involved here. Accordingly, while we have not responded to these charges, we do not, of course, concede that they are in any respect accurate.

they do not claim that any such request was actually made. Indeed, under respondent's submission, a grantee would rarely have any incentive to seek clarification of a vague grant condition.

As participants in the Title I program, respondent and other SEAs have "a duty to familiarize [themselves] with the [governing] legal requirements." *Heckler* v. *Community Health Services*, slip op. 12. But they do not operate the Title I program in a vacuum. The Department has actively sought to ensure that SEAs understand Title I legal requirements by promulgating regulations (which the Board found here were "clear, even to the point of repetition" (Pet. App. 25a)), issuing numerous program guides, holding annual conferences with state personnel, and conducting program reviews. There is continuous communication between Title I program officials at various levels, and technical assistance is provided when requested. In fact, as respondent repeatedly points out, Departmental program review teams were in Kentucky during this period, providing respondent with a convenient opportunity to seek clarification of the alleged ambiguities in the statute and regulations.[9] In addition,

[9] The Board specifically found that "[t]here is no evidence in the record * * * that these teams actually reviewed the fiscal arrangements under which the readiness programs were financed" (Pet. App. 23a). Although respondent does not challenge this finding, amici NAC (Br. 6) suggest the contrary by pointing to a vague comment made by a state official at the oral argument before the Board (Transcript of Oral Argument—Agency Document 25, at 50). Because this comment was made at oral argument—not at an evidentiary hearing—after the evidentiary record was closed, counsel for the Department objected (*id.* at 51) and the Board properly gave no weight to this remark. The Board decided that "it would

the record in this case reflects that in a subsequent year, when respondent finally sought advice from the Department on how to operate this type of program properly, an acceptable funding arrangement was worked out between federal and state officials.[10] Thus, respondent's own experience belies its remarkable suggestion (Resp. Br. 29) that "this Court could probably take judicial notice of the fact federal education officials are not much help in responding to questions."

For the foregoing reasons and the reasons stated in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

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Solicitor General

DECEMBER 1984

be pointless to reopen the record on this point" because there was not even an "allegation of affirmative misconduct" on the part of the program review team or any other federal official. Pet. App. 28a.

[10] Under this funding arrangement, state and local funds paid for 55% of the cost of similar programs while Title I paid for the remaining 45%. Transcript of Oral Argument —Agency Document 25, at 18-19. This is in stark contrast to the FY 1974 readiness programs at issue, where Title I funds paid for virtually the entire cost of the programs.

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